both you and your opponent. As I said, the statistics for the annual survey of the soft drink industry -- survey of the soft drink industry, are garnered in various sources including magazines, newspapers, industry contacts, 10 K's, 10 Q's, and annual reports and the best estimates of a given moment, and they change from year to year as can be seen from perusal of past reports.

These statistics are inexact as indicated by a major revision made of the entire series and particularly to the extent of 32 percent in Coca-Cola in 1972 due to the availability of new data. These numbers are mainly put together to ascertain the general size and shape of the industry as a whole rather than be overexact on the individual companies, and therefore, the numbers of the individual companies should not be taken as Gospel.

Page 1624, Lines 18-25

THE WITNESS: Of those companies that I fully don't have in there or, as I said before, sort of a fudge figure to a degree. I just took a certain percent and presumed that I have covered those percentages in my best estimates.

JUDGE JACKSON: Tell me precisely how did you arrive at this figure?

THE WITNESS: Guess work.

Page 1633, Lines 8-11

JUDGE JACKSON: ... from the witness's statement it does not exist, and if it did exist it isn't very scientific. In fact, it is totally unscientific. It consists of rumor, gossip, and general conversation and hearsay that he collects.

Question 11.

What percent of total soft drink sales is controlled by bottlers with a sales volume of under $500,000?

Answer 11.

Information regarding the percentage of total soft drink sales volume of under $500,000 is not available. Based upon information provided from NSDA membership which represents approximately 75 percent of the soft drink manufacturers in the United States, we would estimate such sales would be approximately 1 percent.

SIC CODE	CLASS OF PRODUCT	PERCENT ACCOUNTED FOR BY: 4 LARGEST COMPANIES	8 LARGEST COMPANIES	20 LARGEST COMPANIES	50 LARGEST COMPANIES
20430	Cereal breakfast foods	84	96	99	100
2066	Chocolate & cocoa products	72	86	9[illegible]	100
20821	Canned beer & ale	59	77	96	100
2076	Vegetable oil mill products	45	70	94	100
2079	Shortening & cooking oils	40	61	87	99
2082	Malt beverages	52	70	91	99
20822	Bottled beer & ale	46	65	89	99
2085	Distilled liquor, except brandy	50	72	90	99
2095	Roasted coffee	64	79	91	97
2074	Cottonseed oil mill products	42	55	74	96
2032	Canned specialities	62	76	89	96
20980	Macaroni, spaghetti and noodles	34	50	74	93
2034	Dehydrated fruits, vegetables & soups	31	50	74	92
2041	Flour & other grain mill products	32	53	76	91
2052	Cookies & crackers	58	67	80	91
2047	Dog, cat & other pet food	50	67	81	90
2017	Poultry & egg processing	23	37	61	86
2037	Frozen fruits & vegetables	28	42	64	86
20910	Canned & cured seafood including soup (except frozen)	38	56	71	85
2087	Flavoring extracts & sirups	62	70	76	84
2038	Frozen specialities	36	48	65	82
2023	Condensed & evaporated milk	34	52	66	80

SIC CODE	CLASS OF PRODUCT	PERCENT ACCOUNTED FOR BY: 4 LARGEST COMPANIES	8 LARGEST COMPANIES	20 LARGEST COMPANIES	50 LARGEST COMPANIES
2035	Pickles, sauces & salad dressings	30	42	57	76
2065	Confectionary products	32	43	59	75
2022	Cheese, natural & processed	40	51	62	74
20240	Ice cream & ices	27	37	54	70
2033	Canned fruits & vegetables	18	29	51	69
2011	Meatpacking plants	26	39	53	67
2099	Food preparations	26	36	50	65
2016	Poultry dressing plants	16	25	42	62
2051	Bread, cake & related products	27	37	48	60
2048	Prepared feeds	22	30	42	57
2026	Fluid milk	17	26	41	54
2013	Sausages & other prepared meats	16	25	37	53
20860	Bottled & canned soft drinks	14	20	32	45

SOURCE: 1972 Census of Manufactures, U.S. Department of Commerce, Bureau of the Census, "Concentration Ratios in Manufacturing"

Louis W. Stern, Oriye Agodo, and Fuat A. Fırat

Territorial Restrictions in Distribution: A Case Analysis

Although the Schwinn decision poses problems for management, the soft drink industry's case for special overriding legislation is a weak one.

TERRITORIAL restrictions often play an important role in agreements between franchisors and franchisees. That is, franchisees may obtain exclusive rights to market the franchisor's brand(s) within a given geographical area; these rights thereby give the franchisees monopoly positions with respect to these brands. From a marketing strategy perspective, such restrictions frequently make sense, because the franchisor is more concerned with the ability of his franchisees to win competitive battles against other brands than he is with their ability to do battle among themselves, thereby cannibalizing one another's sales volume. In the early stages of brand development and growth, such restrictions can be viewed as a needed incentive to secure adequate market penetration vis-à-vis established brands within the same product category. From an antitrust perspective, however, such restrictions are highly questionable because they are a blatant means of prohibiting intrabrand competition. Thus, the issue of territorial restrictions provides an example of a classic confrontation between a marketing strategy that seeks to promote *inter*brand competition and antitrust programs that seek to promote competition among all brands, including those owned by specific franchisors.

Since the Supreme Court's 1967 decision in the *Schwinn* case (which found territorial restrictions in distribution to be illegal on a per se basis),[1] many industries have been operating in limbo with regard to their distribution systems. For the most part, these industries have continued to use past practices pending final clarification of the issue of territorial restrictions.[2] This article assesses the various factors surrounding territorial restrictions in the distribution of soft drinks. The soft drink industry has been isolated for analysis because segments of the industry have been particularly vocal in urging Congress to pass legislation designed to override the *Schwinn* decision. As a result of the assessment presented in this article, the authors take a position opposing the use of territorial restrictions in this industry. A similar analysis to the one presented here can, it is believed, be applied to other product classes in the food and beverage industries (e.g., bread and beer), where such restrictions are prevalent.

Major Theoretical Issue

The primary theoretical issue involved in the legal arguments regarding territorial restrictions concerns whether *intra*brand competition is, from a societal viewpoint, as important as *inter*brand competition. Related to this issue is the question whether restrictions on intrabrand competition should, from an antitrust perspective, be treated as per se violations of the antitrust laws or judged on a rule of reason basis. The position of the U.S. Department of Justice has been that territorial restriction "inhibits second and third-line competition, unless proven otherwise," which seems to indicate that this department would accept "reasonableness" criteria. Furthermore, the Jus-

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

2. The confusion still surrounding this issue has been described in James R. Burley, "Territorial Restriction in Distribution Systems: Current Legal Developments," JOURNAL OF MARKETING, Vol. 39 (October 1975), pp. 52-56.

Journal of Marketing, Vol. 40 (April 1976), pp. 69-75.

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tice Department would probably argue for a rule of reason approach in situations where firms are failing and appear to require territorial protection in order to survive.[3]

Limitations on intrabrand competition have been attacked under the Sherman Act, whereas limitations on interbrand competition have been attacked under Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act, as well as under the Sherman Act. The history of court decisions related to territorial restrictions has been fully presented by McLaren and by Werner;[4] therefore it will not be repeated here. What is crucial in this history for our purposes however, is the fact that the Supreme Court decision in the *Schwinn* case left no ambiguity about the illegality of territorial restrictions in situations where products are *sold outright* to franchisees: such restrictions were found to be unlawful per se. If title, dominion, and risk do not pass to the franchisee but remain with the franchisor, the territorial restrictions are, apparently, acceptable as long as the franchisor does not engage in allied price-fixing activities with his franchisees.[5] Thus, unless the franchisor decides to enter into consignment arrangements, he cannot legally impede intrabrand competition via territorial restrictions. In situations of outright sale, distributors and dealers are free to adopt their own policies with regard to extent of market outreach.

Under these conditions, if individual franchised distributors and dealers decide to invade one another's markets and are successful in doing so, the balance of power within the channel may shift from franchisor to franchisees, especially when the latter begin to control a large amount of sales and develop strong relationships with customers and consumers in vast geographical marketplaces. Thus, from the perspective of countervailing power, territorial restrictions may have added appeal to the franchisor wishing to retain considerable influence within his distribution network.

The desire to avoid intrabrand competition and thus to protect franchisees from one another, combined with the implied desire of franchisors to retain power in their systems, were probably the motivating forces behind the soft drink industry's efforts to obtain legislation that would override the Supreme Court's per se judgment relative to territorial restrictions in the *Schwinn* case. The basic public argument of the industry spokesmen has been that territorial restrictions on intrabrand competition foster more intense interbrand competition and better customer service than would be the case in the absence of such restrictions.

Historical Background of Soft Drink Distribution

To fully understand the issues involved in the soft drink situation, it is useful to review briefly the history of distribution in that industry. The soft drink industry was established in the U.S. in 1807 by local apothecary and pharmaceutical shops. By the close of the nineteenth century, the product had moved beyond these types of outlets.[6]

Many brand names that are familiar today were on the market after the turn of the twentieth century, and franchising systems had begun to be developed. The Coca-Cola Company had incorporated and begun marketing in 1892; by 1904, it had authorized 123 plants to bottle, distribute, and sell its trade-marked product within specified geographic boundaries. Dr. Pepper Company and Seven-Up began franchising systems in 1926 and 1928, respectively.

While some firms attempted to expand their operations without using a franchising system, they soon found that long-distance shipping to wholesale grocers across the country was uneconomical given the cost advantages of local production and the need to recover returnable bottles. Consequently, from the mid-1930s until the mid-1950s, the soft drink industry became almost totally local in bottling and distribution.[7]

The post-World War II period, however, saw four major developments that have helped determine

3. See Betty Bock, *Antitrust Issues in Restricting Sales Territories and Outlets* (New York: National Industrial Conference Board, Studies in Business Economics No. 98, 1967), pp. 17-18.

4. Richard W. McLaren, "Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers, and Handling of Competitive Products," *Antitrust Bulletin*, Vol. 13 (1968), pp. 161-175; and Ray O. Werner, "Marketing and the United States Supreme Court, 1965-1968," JOURNAL OF MARKETING, Vol. 33 (January 1969), pp. 16-23.

5. Werner, same reference as footnote 4.

6. U.S. Congress, Senate, Subcommittee on Antitrust and Monopoly, *Hearings, Exclusive Territorial Allocation Legislation*, 92nd Cong., 2nd sess., August 8, 9, and 10, September 12 and 14, 1972 (Washington, D.C.: U.S. Government Printing Office, 1973), Part 1, p. 15.

7. Same reference as footnote 6, p. 33.

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the current structure of distribution in the industry. They include:[8]

1. *The growth of chain grocers.* The growth of chain grocers over the past 25 years has provided the soft drink industry with an increasingly important set of outlets for attaining the extensive and penetrating distribution that currently is the foundation of the industry. In 1971, chain supermarkets accounted for the largest estimated share (35%) of soft drink sales to the final consumer.
2. *The increased use of one-way (nonreturnable) containers and private labels.* The high cost of handling, storing, and transporting returnable bottles makes their use impractical in warehouse delivery systems. The technological development of one-way containers brought chain grocers into the production and distribution of private-label soft drinks, thereby strengthening the retail market position of the chains as soft drink outlets. In addition, the availability of such containers facilitated the entry of smaller regional firms into the industry and enhanced the ability of all soft drink firms to engage in direct-to-chain warehouse shipments from distant points.
3. *The restructuring of consumer markets.* The shifting demographic characteristics of the U.S. market—including population growth, greater consumer mobility, the expanded highway system, and urban concentration, among others—affected the soft drink industry as directly as they affected all other consumer goods industries. The availability of larger markets to many bottlers has necessitated greater capital requirements and the redefinition of territories. These needs have been increasingly met by mergers, plant conversions, and other intra- and interindustry ownership transactions and arrangements.[9]
4. *The growth in industry sales.* As a result of the restructuring of consumer markets and aggressive marketing, industry sales grew at a rate of 10% per year for the 1960–1970 period. The growth attracted the attention of acquisition-minded firms. This brought about more ownership transfers, many of which were conglomerate in nature (e.g., Westinghouse's purchase of several Seven-Up bottlers). For the first time in the industry's history, "outside" money was attracted to it and companies not previously identified with soft drinks began to enter.

8. Same reference as footnote 6, pp. 34-35.
9. Same reference as footnote 6, p. 225.

Industry Structure and Competition

The foregoing developments have had a fundamental impact on industry structure and competition. To explore this impact in detail, it is useful to divide the industry into its three major components: franchise companies, bottlers, and retailers.

Franchise Companies

For the most part, franchise companies produce flavoring concentrates or syrups which they sell to franchised bottlers who, in turn, formulate branded soft drinks. By 1971, there were approximately 75 franchise companies in the United States. Thirty-six of these companies franchised their products throughout the U.S. Fifty-two of them granted at least one franchise for a trademarked product, while the remaining companies produced flavoring concentrates or syrups on a nonbranded basis for distribution to independent bottlers.[10] The four largest makers of syrup (Coca-Cola Co., PepsiCo, Royal Crown Cola Co., and Seven-Up Co.) control about 70% of the syrup market.[11]

Bottlers

Bottlers are the manufacturers, sellers, and physical distributors of bottled and canned soft drinks. As indicated above, they purchase concentrate or syrup and blend it with carbonated water to produce the final product according to specifications established by the franchise company (if they are franchisees) or to their own specifications (if they are producing their own brands). Three types of firms have come to dominate soft drink bottling:[12]

1. Wholly owned bottling and canning operations of syrup or concentrate producers
2. Bottling plants owned by large conglomerate corporations
3. Large multiplant bottling companies

Firms of these three types accounted for 62.5% of total industry sales in 1967. In view of the significant number of mergers and acquisitions in the industry since 1967, the percentage is undoubtedly higher than this now. More recent data will become available when the U.S. Census Bureau releases the concentration ratio information based on the 1972 census.

10. Appendix: Cresap, McCormick, and Paget, Inc., "A Study of the Soft Drink Bottling and Canning Industry and the Impact of the FTC Complaint on the Industry's Future," same reference as footnote 6, pp. 48-49.
11. Same reference as footnote 6, p. 224.
12. Same reference as footnote 6, p. 222.

The increasing importance of large bottling plants has led to the rapid decline of small and medium-sized plants. The number of soft drink plants dropped from 3,501 in November 1968 to 2,990 in November 1971. During this time, the portion of total soft drink sales accounted for by plants with an annual sales volume of over $2 million increased from 54% to 69%, while the share of total soft drink sales accounted for by plants with annual sales volumes of $500,000 or less fell from 16% to 10%.[13]

Retailers

The third component of the soft drink industry, retailers, represents the final market link in the distribution channel to the ultimate consumer. The major retail outlets in the industry and their estimated shares of soft drink sales in 1971 are listed in Table 1. As indicated, it appears that about 55% of total soft drink sales were made through chain and independent grocery stores that year.

TABLE 1
RETAIL OUTLETS AND THEIR SHARES OF SOFT DRINK SALES IN 1971

Retail Outlet	Percent of Total Sales
Chain supermarkets	35
Grocery and convenience stores	20
Restaurants and bars	15
Service stations	12
Recreational outlets	7
Other "on-premise" outlets	6
Other retail outlets	5

Source: U.S. Congress, Senate, Subcommittee on Antitrust and Monopoly, *Hearings, Exclusive Territorial Allocation Legislation,* 92nd Cong., 2nd sess., August 8, 9, and 10, and September 12 and 14, 1972 (Washington, D.C.: U.S. Government Printing Office, 1973), Part 1, p. 62.

Potential Effects of Eliminating Territorial Restrictions

The above discussion represents an objective picture of the structural evolution of the soft drink industry. This section examines the factors that led us to take a position against legislation that would permit territorial restrictions. The primary question we considered in reaching this position was: What are the likely potential effects of the elimination of territorial restrictions in the industry? In answering this question, we have focused on three key variables that have been discussed in the various arguments offered by the supporters and opponents of territorial restrictions in the soft drink industry: (1) retail prices, (2) market competition, and (3) depth and quality of market coverage.[14]

Potential Effect on Retail Prices

There appears to be general agreement among supporters and opponents of territorial restrictions that the elimination 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 any such price reductions.

The Federal Trade Commission (FTC) has estimated that if territorial restraints were eliminated, the average price of soft drinks could fall by as must as 5%, saving consumers $250 million per year.[15] William Comanor, an opponent of restrictions, has quoted two separate amounts—$100 million and $1.5 billion—as potential consumer savings that might result from their elimination.[16] The lower figure was suggested by Lee Preston,[17] a proponent of the restraints, while the latter was developed by government officials opposing the restraints.

On the other hand, although supporters of restrictions appear to concede potential price reductions, their admission is not without reservations. In fact, Professor Preston questions whether the potential price reductions at the wholesale level in the soft drink industry would automatically be passed along to consumers.[18] Crawford Rainwater, president of the National Soft Drink Association (NSDA), contends that any price reductions to the consumer would be short-lived.[19] Indeed, Mr. Rainwater has suggested that if exclusive territorial arrangements did fall, pressures would be generated that would tend to increase the costs of soft drinks to the consumer at an accelerated rate.[20]

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

13. Same reference as footnote 6, pp. 222-223.
14. Parts of the succeeding discussion are based on Professor Louis W. Stern's testimony, which was reprinted in U.S. Congress, House, Subcommittee on Commerce and Finance, *Hearings, Exclusive Territorial Franchise Act,* 93rd Cong., 2nd sess., June 27 and 28, July 1 and 2, 1974 (Washington, D.C.: U.S. Government Printing Office, 1974), pp. 880-893.

15. Same reference as footnote 6, p. 224.
16. Same reference as footnote 6, p. 453.
17. Same reference as footnote 6, pp. 396 and 453.
18. Same reference as footnote 6, p. 396.
19. Same reference as footnote 6, p. 18.
20. Same reference at footnote 6, p. 19.

qualifying reservations of the former. The arguments that wholesale price reductions might not be passed along to consumers and that price reductions to consumers 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% or 5% 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, in the long run, the larger bottlers would, via price competition, drive the smaller bottlers out of business. Once this market "shakeout" occurred, the larger bottlers would supposedly be left in monopoly positions and thereby be able to charge monopoly prices. As indicated previously, though, a market "shakeout" is already occurring in the soft drink industry and 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. As the earlier discussion has shown, a series of market forces are at the base of the changing conditions in the soft drink industry. 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% have been found to exist between contiguous territories.[21] 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, according to one opponent of territorial restrictions, it costs $1.82 to distribute a case of soft drinks under the present bottling system, versus only 20¢ to distribute a case of comparable merchandise through grocery chain warehouse systems.[22] Because the elimination of restrictions will enable retail grocery chains to deal with distant, price-competitive bottlers shipping one-way containers on a warehouse delivery basis, the lowered distribution cost should lead to downward pressure on consumer prices. Of course, each of the above-mentioned sources of pressure is dependent on whether the price reductions at the wholesale level are passed along to consumers. On the other hand, the surviving bottlers will not be monopolies in the strict economic sense of the term, and it is therefore illogical to expect monopoly pricing behavior in their market conduct, even once the market shakeout has been completed. If individual markets should somehow become monopolized, the Sherman Act already provides an avenue for attacking such conditions.

Potential Effect on Competition

It has been suggested that if territorial restraints were eliminated, some of the largest bottlers would certainly 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, with the result that the number of brands available in those areas would be reduced; that is, there would be a lessening of interbrand competition.[23]

On the other hand, the FTC has shown that there is currently a high level of market concentration in the soft drink industry at both local and national levels.[24] According to the FTC, one result of the high level of concentration is the absence of effective interbrand as well as intrabrand competition. This is due, in part, to the fact that there are a number of large bottlers who hold franchises from more than one syrup manufacturer.

Elimination of territorial restrictions would probably bring about further 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 contiguous territories and to lower consumer prices.

In addition, the small bottler faces a rather untenable position under the present system. Given the 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

21. Same reference as footnote 6, p. 224.
22. Same reference as footnote 14, p. 850.
23. Same reference as footnote 6, p. 395.
24. Same reference as footnote 6, p. 223.

by Arthur MacDonald, president of 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 large volume entities . . . a situation not envisioned in the early years of the industry when franchise boundary lines were established.[25]

Thus, if he is to serve his market area in a satisfactory manner, a small bottler is going to have to undertake some rather costly plant updating. These steps will result in increases in the rated output of his bottling operation that 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, fade from the market 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 who can update his equipment and thereby pursue competitive markets a "fighting chance." The territorial restriction system does not give him this chance because, under it, he must allocate resources inefficiently. With territorial restrictions, the small bottler is faced with redundancy, eventual bankruptcy, or disappearance as a separate independent entity through merger.

It is no doubt true that eliminating 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 FTC has aptly pointed out that survival or success under the present territorially limited system may not depend on a bottler's industry, judgment, or skill, the economies of his operations, or the quality of his service, as much as it does on the boundaries of his territory.[26] In other words, the existing system does not 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; rather, it limits the competitiveness and opportunities for growth of the efficient bottler, irrespective of size.

Potential Effect on Market Coverage

Soft drink industry spokesmen believe that the existing territorial system has been an instrument for developing the deepest distribution and the highest level of product availability, because it has enabled franchisors to increase sales volumes without having to make the substantial capital outlays that would otherwise have been required to secure such distribution. This view holds that the right to an exclusive territory is an incentive necessary to lure and motivate franchisees. Thus, if this right were taken away, franchisees might no longer find any attraction in bottling, might decide to disinvest, or might be taken over by the larger firms, and a lower level of market penetration could result.

While this argument is, to some extent, relevant for an emerging industry or distribution system, it has little support in the case of an established, ongoing situation where profits are positive. Professor Comanor has stated the case explicitly and well.[27] He has persuasively argued that territorial restrictions on competition are not needed to induce capital investment throughout the economy, because real investment in economic activities is generally forthcoming whenever the prospective rate of return exceeds the cost of additional capital. So long as the return in an industry 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. In addition, 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 distribution facilities, the normal functioning of the market creates temporarily higher markups and increased distributor profits. As Professor Comanor notes, these increased profits, rather than restrictions on competition, serve as a signal for new investment.

This basic process of resource allocation in a free enterprise economy must, therefore, be seen as the primary source of motivation for investment in the bottling and distribution of soft drinks. Thus, eliminating the existing territorial restrictions per se may not affect the level of investment in this branch of the industry. The existing depth of market penetration and level of product availability are

25. Same reference as footnote 6, p. 198.
26. Same reference as footnote 6, p. 225.
27. Same reference as footnote 6, p. 446.

almost certain to be unaffected by eliminating territorial restraints.[28]

On the other hand, one could effectively argue that territorial restrictions might be needed if they were the *only* means by which a new manufacturer could secure entry into an industry. Despite the per se ruling by the Supreme Court in the *Schwinn* case, this belief has been advanced in the various cases on the issue of territorial restrictions over the years and has found support in the lower courts.

It is likely that the territorial protection given to bottlers in the early years did speed market penetration and save resources. But the industry is now mature and well established. There is no logical reason why natural market forces should not now determine which bottlers succeed and which fail. Protection under the law—through permitting territorial restrictions—is contrary to the established congressional doctrine of promoting interbrand *and* intrabrand competition, especially in a situation where brands are strongly established. Perhaps if a new firm were to enter with a new brand, it might need the right to invoke such restrictions for a short period of time until it became established, but the present competitors in the soft drink industry are far from being newcomers to the market.

Summary and Conclusions

In October 1975, an administrative law judge at the Federal Trade Commission ruled in favor of exclusive territories for Coca-Cola and Pepsi-Cola.[29] Since this case is subject to appeal, the final decision is still very much in question. It is evident, though, that the issue continues to be a prominent one for both government and the industry.

One of the primary questions surrounding the issue of territorial restrictions in distribution is whether or not new legislation is warranted that would allow firms to maintain or implement such restraints. A major concern here is the possible effect on price competition. Indeed, 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 adequately with predatory conduct. If territorial restrictions are eliminated, price competition should be enhanced; the consequences for those who cannot compete efficiently are obvious. Congressional and judicial actions in the past have confirmed that price competition is desirable; legislation permitting territorial restrictions may not serve to enhance it if, in fact, the situation in the soft drink industry is mirrored by other industries.

Natural market forces are basically at the root of what is happening in the soft drink industry. They should be permitted to run their course. New technological developments, marketing breakthroughs, new forms of communication, and the like, have combined to inhibit the independent businessman from existing within a small territory. Even medium- and large-sized bottlers should be free to challenge the positions of one another in order to take full advantage of economies of scale. Thus, overriding the *Schwinn* decision does not appear warranted for this industry, although there are undoubtedly circumstances that would favor a return to a rule of reason approach on the issue rather than application of the per se doctrine enunciated in *Schwinn*.

Finally, it is important to note that existing laws are available to curb concentration of markets should increased concentration occur as the result of the elimination of territorial restrictions. Because one of the major concerns with the situation in the soft drink industry involves increased concentration, careful thought should be given to applying the Sherman Act in specific markets. In addition, the applicability of the Celler-Kefauver Amendment to mergers (both horizontal and conglomerate) in the soft drink industry should be investigated. But to assume that new legislation permitting territorial restrictions will make for a more competitive system in the long run is erroneous. We cannot make progress by standing in the way of natural market forces in order to protect individual competitors from competition.

28. Same reference as footnote 6, pp. 446-447.

29. In re The Coca-Cola Co. et al., 3 Trade Reg. Rep. ¶ 21,010 (October 1975).

NINTH CIRCUIT'S OPINION IN FIRST BEVERAGES INC. OF LAS VEGAS v. ROYAL CROWN COLA CO.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FIRST BEVERAGES, INC. OF LAS VEGAS, a Nevada corporation, and NORTON PACKAGING, INC. OF ARIZONA, an Arizona corporation,
Plaintiffs-Appellants
and
WILL NORTON,
Counter-Defendant-Appellant,
vs.
ROYAL CROWN COLA CO., a Delaware corporation, and ROYAL CROWN BEVERAGE CO., etc., et al.,
Defendants-Appellees.

No. 77-3536

H&M SALES CO., INC. and MAE-CON ENTERPRISES, INC.,
Plaintiffs-Appellants,
vs.
ROYAL CROWN COLA CO., et al.
Defendants-Appellants

No. 78-1050

OPINION

Appeal from the United States District Court
for the Central District of California

Before: CHOY and TANG, Circuit Judges, and FOLEY,*/ District Judge.

CHOY, Circuit Judge:

Appellants filed suit contending that Royal Crown Cola Co.'s vertically-imposed territorial market restrictions violated §1 of the Sherman Antitrust Act. Royal Crown responded that its exclusive territorial trademark licensing system was lawful and filed breach of contract and antitrust counterclaims against appellants.

The jury found in Royal Crown's favor on appellants' claims and on the counterclaims. We affirm.

I. Statement of the Case

Royal Crown is a well-established soft drink manufacturer. It sells soft drink concentrate to its bottlers, who mix the concentrate with sugar and water, add carbonate gas, and bottle the resulting soft drink, all according to strick standards imposed by Royal Crown. The bottlers normally then sell the bottled soft drinks to retail outlets. There generally are no intermediaries in the distribution chain between the bottlers and the retail outlets.

The bottlers also distribute canned soft drinks, but do not manufacture them. Royal Crown supplies all the raw products for canned soft drinks to contract canners such as Norton Packaging. The canners produce the finished canned drinks and are paid for their services on a volume basis. The title to the cans and their contents at all times remains with Royal Crown. Royal Crown sells the finished canned soft drinks to its licenced bottlers for distribution.

During 1969 and 1970, First Beverages, Inc. was a licensed bottler of Royal Crown. Its licensing agreements with Royal Crown gave it the right to purchase soft drink concentrate, to manufacture bottled soft drinks and to sell bottled and canned soft drinks under Royal Crown's trademarked names in a "restricted" territory. The restricted or exclusive territory assigned to First Beverages was the Las Vegas, Nevada area.

Bottlers such as First Beverages are not allowed to sell Royal Crown products outside of their exclusive territories. This eliminates intrabrand competition. Apparently all major soft drink manufacturers use similar exclusive license distribution schemes. See In The Matter of the Coca-Cola Co., No. 8855 (F.T.C. April 25, 1978), Trade Reg. Rep. (CCH) Supp. No. 330; In the Matter of PepsiCo, Inc., No. 8856, id. However, the FTC has recently declared that Coca-Cola Co.'s and PepsiCo's territorial distribution restrictions are unlawful, insofar as they apply to distribution of soft drinks in non-returnable containers. Id. 1/

A. Central Warehousing

In recent years, there has been a trend in the retail grocery industry toward developing central warehouse distribution systems. In a central warehousing system, a grocery chain or cooperative grocery-buying association buys goods in large lots from manufacturers and suppliers. The goods are delivered to a central warehouse by the manufacturer or supplier. From there, trucks belonging to the chain or cooperative haul the goods to individual retail stores.

Such a system benefits the chains and cooperatives. They pay less for the products than they would if the supplier made delivery to individual stores. Also, they can consolidate deliveries from the warehouse to individual stores. Thus, their savings due to buying in large lots and arranging for central delivery are greater than their added delivery costs.

Many grocery chains and cooperatives operate central warehouses in the Los Angeles/Orange County, California area. These central warehouses serve wide geographic areas, including some stores in the Las Vegas area.

B. Sales to Operators of Central Warehouses

1. The Los Angeles Royal Crown Bottler

In the mid-1960's, the Los Angeles Royal Crown bottler began selling and delivering soft drinks to central warehouses in the Los Angeles/Orange County area, an area within its exclusive selling territory. Soft drinks from those warehouses were delivered into the exclusive territories of other Royal Crown bottlers, including First Beverages' Las Vegas territory.

The bottlers into whose areas the Southern California central warehouses were delivering complained to the Los Angeles bottler. The Los Angeles bottler refused to stop delivering to the warehouses. When Royal Crown was apprised of the situation, it took no action.

2. First Beverages' Sales

In July 1970, H & M, a Los Angeles food broker, inquired whether or not First Beverages would be interested in selling large quantities of soft drinks for delivery to Alpha Beta, a large supermarket chain, at its Southern California central warehouse. First Beverages agreed to sell the soft drinks to Mae-Con, a Las Vegas food distributor. Mae-Con took title to the soft drinks in Las Vegas, arranged for their shipment and resale in Los Angeles and paid H & M's brokerage fees. The truckers used by Mae-Con were not licensed to carry goods for hire in interstate commerce by the ICC and charged substantially less than the ICC-authorized rates for delivery. Royal Crown characterizes this agreement as a conspiracy to undermine its distribution system and argues that Mae-

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*/ The Honorable Roger D. Foley, United States District Judge for the District of Nevada, sitting by designation.

1/ The United States Court of Appeals for the District of Columbia Circuit currently is considering an appeal from the FTC's decisions in these cases. Coca-Cola Co. v. FTC, No. 78-1364 (heard Oct. 25, 1978).

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Con's taking title was a sham designed to mislead Royal Crown into believing that First Beverages was selling within its territory when in fact it was selling directly to Alpha Beta in Southern California.

The Los Angeles bottler discovered that soft drinks produced in Las Vegas were coming into its territory and complained to Royal Crown. Royal Crown investigated the complaint and decided to take action against First Beverages and its principal owner. 2/ It issued two letters: one to First Beverages indicating that it was limiting the amount of concentrate it would sell to First Beverages in the future to an amount based on its average past monthly sales (before sales to Mae-Con began), and one to Norton Packaging indicating that Norton Packaging's canning contract would be terminated in 60 days. Royal Crown enforced neither of these letters--a few weeks after the letters went out First Beverages sold its Royal Crown franchise to a company which agreed to terminate the Alpha Beta sales, and, apparently because of this turn of events, Norton Packaging was continued as a contract canner until it went out of business several years later.

C. Proceeding Below

First Beverages and Norton Packaging filed suit against Royal Crown in October of 1974. About one month later, H & M and Mae-Con filed a similar suit. All of these appellants alleged that Royal Crown's franchise system and other actions violated the antitrust laws.

Royal Crown responded that its franchise system was lawful and asserted counterclaims against the plaintiffs and Will Norton. Royal Crown urged that appellants have violated the antitrust laws by breaching and conspiring to breach First Beverages' bottling agreement. Breach of contract and related counterclaims were also stated.

Trial began in August, 1976, and ended in October of the same year. Near the end of the trial, the district court concluded that Royal Crown's territorial restraints had to be judged under the rule of reason. The court therefore refused appellants' proferred per se instruction and gave a rule of reason instruction. 3/

The jury found for Royal Crown both on appellants' claims and on Royal Crown's counterclaims. Royal Crown was awarded $500 on each of its six counterclaims that went to a verdict: the amount was trebled for the five antitrust claims. The jury's verdict was filed on October 5, 1976, and judgment was entered a week later. 4/

II. Appellants' Antitrust Claims

Appellants contend that an intervening change of law requires that their antitrust claims be retried. They also argue that the district court committed several other errors during the trial.

A. Refusal to Give a Per Se Instruction

Appellants proposed that the jury be given an instruction that a vertical territorial restraint is per se unreasonable and violative of Sherman Act § 1. 5/ The district court refused to give such an instruction and instead gave a "rule of reason" instruction.

Appelants argue that the district court erred, under the law as it stood at the time of trial, in refusing their proffered per se instruction, citing United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), and Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 45-46 (1977). However, they recognize that the district court's refusal to give a per se instruction based on Schwinn was vindicated by the Supreme Court's GTE Sylvania opinion. 433 U.S. at 47-59. 6/

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2/ Norton Packaging owned more than 75% of First Beverages' outstanding stock. Norton Packaging was owned and managed by Will Norton.

3/ The trial court gave the following rule of reason instruction:

> In determining whether or not a particular restraint is reasonable or unreasonable and therefore that it is or is not a violation of the antitrust laws, you may consider:
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> First: The nature of the particular industry involved;
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> Second: Facts which are peculiar to the business in which the restraint is applied;
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> Third: The nature of the restraint and its effect, actual and probable, upon soft drink bottlers and upon consumers;
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> Fourth: The history of the restraint; and
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> Fifth: The reasons for adopting the practice.

4/ The judgment was amended several times in January and July of 1977. The amendments made provisions for the award of costs and attorney's fees to Royal Crown.

5/ Appellants requested that the following per se instruction be given:

> There are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuses for their use. Such agreements or practices are termed per se unreasonable, and are not to be tolerated even if they are well-intended or because they are allegedly developed to increase competition.
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> A vertical territorial restraint is a restraint imposed by a manufacturer as a condition of doing business with a dealer or distributor. A vertical territorial restraint is a per se violation of § 1 of the Sherman Antitrust Act where a manufacturer of a product, which manufacturer is neither a new entrant in the business nor a failing company, sells its product to its dealer or distributor and thereafter, by agreement with the dealer, prohibits the dealer from selling to persons located outside of a specifically designated territory. The rule that a vertical territorial restraint is per se unreasonable does not apply in the situation where the manufacturer delivers his products to a dealer whose position and function are, in fact, indistinguishable from those of an agent or salesman of the manufacturer and the manufacturer completely retains all indicia of ownership including title, dominion, and risk.

The instruction concludes with a direction that the jury find that the Royal Crown franchise agreement per se violated § 1.

6/ One explanation for the district court's refusal to give a per se instruction may be found in our decision in GET Sylvania Inc. v. Continental T.V., 537 F. 2d 980 (9th Cir. 1976). There, we distinguished Schwinn on several grounds: the nature of the restrictions involved, their effect upon competition and the market shares of the parties imposing the restrictions. See Continental T.V., Inc., v. GTE Sylvania Inc., 433 U.S. at 41.

At the time of the trial in this case, the rationale of our GTE Sylvania decision had not yet been rejected by the Supreme Court. The district court therefore ordered the parties to submit memoranda likening the case before it to either Schwinn or our GTE Sylvania. Based upon these memoranda and the record before it, the court adopted the rule of reason as the appropriate yardstick by which to measure Royal Crown's conduct.

The Supreme Court reviewed our GTE Sylvania decision after judgment had been entered in this case. While rejecting our distinction, it affirmed our judgment that the GTE Sylvania restrictions could not be analyzed under the per se rule. As we point out in this opinion, the Supreme Court also effectively ratified the district court's decision to apply the rule of reason in this case.

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Nonetheless, they contend that they are entitled to a new trial. They maintain that while GTE Sylvania overruled the Schwinn per se rule, it did not preclude per se treatment of all vertical territorial restrictions, but merely changed the "burden of proof" regarding the propriety of a per se instruction. They argue that they should be given an opportunity to meet this new burden of proof.

In GTE Sylvania, the Supreme Court overruled its ten-year-old holding in Schwinn that all vertically imposed restrictions on the resale of goods sold to a distributor were per se violative of § 1. The court said:

> We revert to the standard articulated in Northern Pac. R. Co. [v. United States, 356 U.S. 1 (1958)], and reiterated in White Motor [Co. v. United States, 372 U.S. 253 (1963)], for determining whether vertical restrictions must be "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." 356 U.S., at 5. Such restrictions, in varying forms, are widely used in our free market economy. As indicated above, there is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary. Certainly, there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a "pernicious effect on competition" or that they "lack. . . any redeeming virtue." Ibid. Accordingly, we conclude that the per se rule stated in Schwinn must be overruled. In so holding we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under Northern Pac. R. Co. But we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than--as in Schwinn--upon formalistic line drawing.
>
> In sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to Schwinn. When anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under § 1 of the [Sherman] Act. 433 U.S. at 57-59 (footnotes omitted).

One of the restrictions involved in the Schwinn case was a vertical territorial restriction legally indistinguishable from the restriction of which the appellants in this case complain. 7/ The Court, in declaring the restrictions involved in Schwinn to be legally indistinguishable from those it faced in GTE Sylvania, 433 U.S. at 46, and in holding that the GTE Sylvania restrictions could not be subjected to per se analysis, impliedly held that vertical territorial restrictions such as those involved in the case before us must be analyzed under the rule of reason. While the Supreme Court may have left open the possibility that some vertical restrictions may be analyzed under the per se rule when a showing of pernicious economic effect or lack of any redeeming virtue is made, it has clearly indicated that the economic effects of vertical non-price restrictions such as the one challenged here are now too uncertain to justify departure from the traditional rule of reason. Therefore, there is no need to remand this case so that appellants have an opportunity to meet the "new burden of proof" regarding per se analysis. The Supreme Court has decided that the restraint involved in this case must be analyzed under the rule of reason as it was below. See Reno-West Coast Distribution Co. v. Mead Corp., No. 77-1029, slip op. at 554, 557, ___ F.2d ___, ___, 1979-1 Trade Cas. para. 62, 544 (9th Cir. Feb. 21, 1979), cert denied, 48 U.S.L.W. 3291 (U.S. Oct. 29, 1979).

B. The Rule of Reason Instruction

Appellants next contend that they are entitled to a new trial because GTE Sylvania "cast additional light on the proper application of the rule of reason in vertical territorial restraint cases." They claim that this "elaboration" makes the rule of reason instruction given in this case "misleading."

Specifically, appellants contend that GTE Sylvania emphasizes consideration of intrabrand and interbrand competition. They also argue that the Supreme Court made clear, for the first time, that methods of product promotion that could be used in the absence of territorial restrictions should be considered by the jury. Their claim is based upon the Court's discussion of the relationship of intrabrand and interbrand competition, 433 U.S. at 51-57, and its discussion of promotional activities, id. at 56 n. 25.

The thrust of the Supreme Court's discussion of interbrand and intrabrand competition in GTE Sylvania is that not enough is known about the overall effects of vertical territorial restrictions on all competition--both interbrand and intrabrand--to justify application of a per se rule. Id. at 51-52, 57-58. 8/ Similarly, its discussion in footnote 25 of promotional activities is a direct response to a commentator's assertion that the promotional activities encouraged by vertical restrictions result in decreased interbrand competition and is directed to the same end as the interbrand-intrabrand discussion: showing that not enough is yet known about the effects of vertical territorial restrictions to justify departure from the rule of reason.

The Supreme Court was not concerned in GTE Sylvania with refining the rule of reason. Instead, its concern was with the Schwinn per se rule and the lack of justification for Schwinn's departure from the rule of reason. This is made clear by the context of the Court's discussions of interbrand and intrabrand competition and of promotional activities. See 433 U.S. at 51-58. Further support for this reading of GTE Sylvania can be found in the Court's quotation of the traditional rule of reason formulation, with apparent approval. Id. at 49 n. 15, quoting Chicago Board of Trade v. United States,

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7/ That restriction was described in GTE Sylvania as follows: "Each distributor had a defined geographic area in which it had the exclusive right to supply franchised retailers." 433 U.S. at 42. This restriction is one of many involved in Schwinn. See 433 U.S. at 42-43; United States v. Arnold, Schwinn & Co., 388 U.S. at 370-71.

8/ The Supreme Court and this court indicated before the trial in this case that both interbrand and intrabrand competition must be considered under the antitrust laws. See, e.g., White Motor Co. v. United States, 372 U.S. at 266-70 (Brennan, J., concurring); United States v. Arnold, Schwinn & Co., 388 U.S. at 369-70, 379-82; GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d at 1000-01.

Appellants also apparently recognized that both interbrand and intrabrand competition and their relationship should be considered. During their opening statement, H & M and Mae-Con indicated that they would present evidence that the restriction involved had anticompetitive effects on both interbrand and intrabrand competition. Royal Crown also addressed this issue in its opening statement. Moreover, evidence concerning the effects of the restriction here challenged on both interbrand and intrabrand competition was presented at trial.

Therefore, we reject appellants' contention that they were not aware of the importance of both interbrand and intrabrand competition prior to the Supreme Court's discussion of them in GTE Sylvania.

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246 U.S. 231, 238 (1918). 9/ See also, Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883, 885 (1st Cir.) (quoting with approval the Chicago Board of Trade formulation of the rule of reason after the GTE Sylvania decision), cert. denied, 439 U.S. 833 (1978); Martin B. Glauser Dodge Co. v. Chrysler Corp., 570 F.2d 72, 82 n.20 (3d Cir. 1977) (GTE Sylvania did not "affect the analysis under the rule of reason test"), cert. denied, 436 U.S. 913 (1978).

The district court gave a traditional rule of reason instruction closely paralleling the statement of the rule of reason found in Chicago Board of Trade. Compare note 3 supra with note 9 supra. Appellants conceded that this instruction was a correct statement of the rule of reason as it existed at the time of trial. Since GTE Sylvania did not affect rule of reason analysis, the instruction given is just as sufficient after GTE Sylvania as it was before the Supreme Court issued its opinion in that case. If anything, the Court's approval of the Chicago Board of Trade statement of the rule of reason in GTE Sylvania "ratifies" the district court's instruction.

C. Evidence of Similar Restrictions Imposed By Competitors

Royal Crown adduced evidence at trial that Coca-Cola Co. and PepsiCo--two of Royal Crown's competitors --used vertical territorial restrictions in marketing their products similar to those utilized by Royal Crown. In closing, Royal Crown argued that it would be unfair in effect to deny it the use of such a restriction by holding it liable for imposing the restriction when Coca-Cola Co. and PepsiCo, the industry giants, used a similar distribution system.

After trial, the FTC held that the Coca-Cola and PepsiCo restrictions violated §5 of the Federal Trade Commission Act. In the Matter of the Coca-Cola Co., No. 8855 (F.T.C. April 25, 1978), Trade Reg. Rep. (CCH) Supp. No. 330; In the Matter of PepsiCo, Inc., No. 8856, id. These decisions have been appealed to the Court of Appeals for the District of Columbia Circuit. Coca-Cola Co. v. FTC, No. 78-1364 (heard October 25, 1978).

Appellants argue that the FTC decisions make a remand necessary. They contend that the evidence adduced by Royal Crown and its closing argument implied that Coca-Cola's and PepsiCo's restrictions were lawful. They concede that this implication was not incorrect as of the time of trial, as no tribunal had yet held those territorial restrictions violative of the antitrust laws. However, they maintain, the FTC decisions changed the law and make the implication of lawfulness incorrect today.

The FTC decisions in Coca-Cola and PepsiCo did not work an intervening change in the law. In those cases, the FTC merely applied the existing law under GTE Sylvania: that vertical territorial restrictions must be analyzed under the rule of reason. 10/

At most, the FTC decisions affect the factual circumstances surrounding the case. That a tribunal has subsequently held illegal the Coca-Cola and PepsiCo restrictions relied upon by Royal Crown to justify its adoption of similar restrictions is a new fact not in existence at the time of trial. The proper approach to seeking relief from judgment because of a change in the factual circumstances surrounding this case would be to make a Rule 60(b) motion or a motion to reopen to hear additional proof. Such motions must be directed in the first instance to the district court. The trial court, having heard all of the evidence in a case, is in a much better position than is this court to decide whether or not the new evidence justifies relief from judgment. See Thomas v SS Santa Mercedes, 572 F. 2d 1331, 1336 (9th Cir. 1978); Martella v. Marine Cooks & Stewards Union, 448 F. 2d 729, 730 (9th Cir. 1971), cert. denied, 405 U.S. 974 (1972); 11 C. Wright & A. Miller, Federal Practice and Procedure § 2865, at 224-25 (1973). This court's role, with regard to a Rule 60(b) motion or a motion to reopen, is limited to reviewing the decision of the district court to determine if there was an abuse of discretion. Browder v. Director, 434 U.S. 257, 263 n. 7 (1978). 11/

We therefore decline to remand this case because of the FTC decisions in Coca-Cola and PepsiCo.

D. Acquiescence and Participation: The Pari Delicto Defense

In Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968), the Supreme Court declared that "the doctrine of in pari delicto, with its complex scope, contents, and effects, is not to be recognized as a defense to an antitrust action." Id. at 140, quoted in Memorex Corp. v. IBM, 555 F. 2d 1379, 1381 (9th Cir. 1977). The doctrine of in pari delicto is that a plaintiff who has participated in wrongdoing cannot recover when he suffers injury as a result of the wrongdoing. Memorex Corp. v. IBM, 555 F. 2d at 1381.

Before trial, Royal Crown argued to the court that Perma Life did not bar a defense based upon appellants' "truly complete involvement and participation in a monopolistic scheme," Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. at 140, and asserted such a defense in its papers. Appellants moved for a partial summary judgment on this defense, or in the alternative for an order in limine excluding evidence of the pari delicto defense from trial. While the district court never ruled on appellants' motion in the alternative, it did refuse to instruct the jury on anything resembling a pari delicto defense.

Appellants contend that this refusal to instruct does not cure the error they claim the district court made when it did not grant their motion in the alternative. They argue that certain evidence was admitted tending to establish the pari delicto defense and that Royal Crown's closing argument emphasized that evidence to the jury.

Having carefully reviewed the record, and paying particular attention to the testimony and argument that appellants contend tends to establish and emphasize the

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9/ The Chicago Board of Trade formulation cited by the Supreme Court reads as follows:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

246 U.S. at 238.

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10/ Of course, even if the FTC had adopted a new rule of law or changed existing law, we would not be bound by the new FTC rule.

11/ We express no opinion on the merits of such a motion.

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pari delicto defense, we conclude that if the district court erred in failing to grant appellants' motion in the alternative, that error was harmless. The evidence adduced by Royal Crown did not tend to show that appellants had conducted themselves illegally or inequitably, nor did Royal Crown argue that appellants should recover nothing because of their illegal or inequitable conduct. The legality and equity of appellants' conduct were never raised. Instead, the evidence adduced tended to show that appellants were familiar with territorial restrictions such as those at issue in this case, felt that they could make a profit with these restrictions or that the restrictions were necessary to their running a profitable enterprise, and that the restrictions in no way prevented them from doing anything they wanted to do. Royal Crown's closing argument emphasized this evidence only as tending to show the reasonableness of the restrictions and that appellants suffered no injury as a result of the restrictions.

Perma Life and Memorex teach that private wrongdoing should not be a bar to an action for the public wrong of violating the antitrust laws. 392 U.S. at 138-39; 555 F.2d at 1382. They do not foreclose the introduction of evidence for purposes other than to show an antitrust plaintiff's improper conduct. They either bar evidence of plaintiff's acceptance and advocacy of the restrictions challenged as relevant to the question of the reasonableness of the restrictions, nor ban evidence that the plaintiff claimed not to have violated the restrictions and never intended to violate them on the question of injury due to imposition of the restrictions.

Here, the jury was never presented with evidence or argument that appellants' acquiesence and participation in, and advocacy of, the territorial restrictions contained in the Royal Crown franchise agreement were somehow improper and therefore precluded recovery on the antitrust claim. Moreover, the court properly refused to give an in pari delicto instruction. Under such circumstances, we reject appellants' contention that an improper pari delicto defense was presented.

E. Evidence of Illegal Trucking Arrangements: The Quasi Unclean Hands Defense

Appellants' final contention with regard to their antitrust claims against Royal Crown is that the district court erred in allowing Royal Crown to present evidence concerning the illegality to the arrangement under which appellants' product was shipped to Los Angeles. Appellants argue that Royal Crown was thereby allowed to present an "unclean hands" defense barred by Memorex.

Prior to trial, Royal Crown argued:

> It is defendants' position that plaintiffs' illegal back-haul activity is relevant to (1) the fact of damage, (2) the amount of damages, if any, (3) whether the scheme would have been promptly halted by the ICC, and (4) whether there is a legally cognizable cause of action.

Over appellants' objection, the district court ruled that while it did not believe that appellants' illegal trucking arrangements barred their antitrust claims completely, evidence of unlawful shipment was admissible on questions of damages and related matters. 12/

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12/ Appellants argue that the jury might have considered the evidence on the question of the reasonableness of the franchise restraint. In this argument, they rely heavily on Royal Crown's pretrial statement that such evidence would be relevant on the question of reasonableness as well as on damages issues.

We reject this position. Royal Crown's pretrial argument was intended to convince the court that the "gypsy" trucking evidence should be admitted for more than just the issue of damages. The court rejected Royal Crown's argument and expressly limited such evidence to that issue. Therefore, appellants' reliance on Royal Crown's pretrial and pre-ruling statements is misplaced.

At trial, Royal Crown presented testimony concerning the arrangement whereby First Beverages' product was shipped to Los Angeles area central warehouses, to show that: (1) the amount paid for each shipment from Las Vegas to Los Angeles was between $100 and $150, (2) at the relevant time, the ICC common carrier minimum rate for such a shipment was $492; (3) the truckers carrying the goods into Los Angeles for appellants did not have the proper ICC authorization to do so; (4) the common carriers licensed to haul goods along that route would have soon complained to the ICC of the "gypsy" or unlicensed trucking operation; and (5) the ICC would have taken action to stop the illegal arrangement soon after it had been informed of its existence.

At the close of trial, appellants emphasized to the jury in their closing argument that the court would instruct the jury that the illegal trucking evidence could be "considered by you for one reason only": to "determin[e] the amount of profits plaintiffs would have made" in the absence of the territorial restrictions. Royal Crown similarly argued that the illegal shipping arrangements should be considered, because "[t]he authorities will put a stop to it. And, therefore, you can't fairly make projections of profit, loss, sales, whatever, . . . when you should be paying . . . substantially more" for transportation.

Along the same line, the court instructed the jury as follows:

> In addition to its defenses, Royal Crown Cola contends that plaintiffs' damages, if there were any, must be diminished because the shipping arrangement employed by the plaintiffs contravened federal law permitting profits that would not otherwise have been available.
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> . . . . .
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> Plaintiffs claim as their damages profits which they would have made, had their shipping and sales arrangements of the late 1970's [sic -- the court meant late 1970] continued for several years. In determining the amount of these lost profits, if any, you are entitled to consider defendant's evidence that the shipping arrangements which were used for the actual sales and deliveries to Alpha Beta may have been contrary to federal statutes and the rules and regulations of the Interstate Commerce Commission. You are entitled to consider and to determine the possibility that, at some time after October, 1970, the Interstate Commerce Commission might have obtained an order stopping those truckers from continuing to transport Royal Crown products to the Southern California area from Las Vegas. Thus, you are entitled to consider the possibility of increased shipping costs and decreased profits.

After careful review of the record, we find that the jury was never informed by the district court's instructions, by Royal Crown's closing argument, or by Royal Crown's manner of presenting the evidence, that the illegality of the trucking arrangement might constitute a complete affirmative defense.

Thus this case could not violate the principle of those cases holding that a plaintiff's illegal conduct cannot be raised as a complete bar to his antitrust action. See Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. at 138-41 (in pari delicto; plaintiff's participation in complained-of franchising scheme); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 214 (1951) (unclean hands: plaintiff's participation in price-fixing scheme unrelated to complained-of maximum resale price restriction and concerted refusal to deal); Memorex Corp. v. IBM, 555 F.2d at 1380-82 (illegal market pre-

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The district court clearly limited the jury's consideration of the illegal shipping arrangement to the issue of damages, and used an instruction proposed by appellants in doing so.

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sence: plaintiff's theft of trade secrets from defendant was the source of the sales plaintiff allegedly lost); Calnetics Corp. v. Volkswagen of America, Inc., 532 F.2d 674, 688-89 (9th Cir.) (same: sales based on illegal commercial bribery), cert. denied, 429 U.S. 940 (1976).

The reason why illegal conduct by an antitrust plaintiff cannot completely and automatically bar his claim is that

> the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws. The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition.

Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. at 139; see Memorex Corp. v. IBM, 555 F.2d at 1382.

Appellants claim that this doctrine has been extended by this court's dictum in Memorex v. IBM Corp., id., at 1384 n.8, so that Royal Crown could not properly use evidence of the illegal trucking arrangement even to argue for reduced damages. We disagree. Memorex held that Memorex's antitrust action against IBM would not be barred even if Memorex's lost sales were founded on Memorex's theft of trade secrets from IBM. We added that IBM could use evidence of the theft for impeachment purposes or to prove that a prior action based on the theft was filed in good faith, but not to reduce damages. Id. The point of this footnote is that where the illegal act by the plaintiff is directed against the defendant, the defendant should not use this fact to reduce his liability for his own breach of public policy, but should bring a counterclaim based on the plaintiff's breach of public policy. See id. at 1382-83; Calnetics Corp. v. Volkswagen of America, Inc., 531 F.2d at 689 (counterclaim asserted). Then both public wrongs may be formally vindicated, instead of only one or neither. The defendant's illegal conduct does not bar the counterclaim, of course, for the same reason that the plaintiff's illegal conduct does not bar the claim.

Unlike the Calnetics and Memorex defendants, Royal Crown introduced evidence of illegality not to prevent the appellants from presenting any case at all, but to show that some or all of the alleged lost profits would never have materialized. The illegality was not attacked on an abstract level; instead, Royal Crown tried to show that in fact the ICC would have intervened.

Moreover, the Memorex footnote is inapplicable where, as here, the plaintiff's illegal conduct was not directed at the defendant. See 555 F.2d at 1382 n. 5. Royal Crown has no claim or counterclaim based on the trucking arrangement. Since the policy reasons underlying the Memorex dictum are absent here, it was proper for Royal Crown to introduce its evidence to disprove part or all of the claimed damages. Any other rule would allow plaintiffs to recover, trebled, more than actually compensatory damages.

III. Royal Crown's Counterclaims

Royal Crown asserted antitrust and breach of contract counterclaims against appellants. The jury returned general verdicts in the amount of $500 against each appellant on the antitrust counterclaims. The court trebled these awards pursuant to § 4 of the Clayton Act, 15 U.S.C. §15. The jury also returned a verdict against First Beverages on Royal Crown's breach of contract counterclaim in the amount of $500. Finally, the court awarded Royal Crown costs and $10,000 in attorney's fees.

Appellants argue that the district court erred with reference to the counterclaim. They make two claims.

Appellants first contend that Royal Crown asked for and received only nominal damages, not actual damages, on each of its counterclaims. 13/ Royal Crown disputes this characterization of its prayer, arguing that it presented substantial evidence concerning its actual damages of between $18,000 and $20,000 due to appellants' actions. It maintains that it merely "voluntarily scaled down the amount of actual damages claimed to $500 per party on each counterclaim."

It is a fundamental principle of antitrust law that a plaintiff must show that it has suffered some actual "antitrust injury" in order to prevail in a treble damage action. Clayton Act § 4; see Kapp v. National Football League, 586 F.2d 644, 648-49 (9th Cir. 1978), cert. denied, ___ U.S. ___, 99 S.Ct. 1996 (1979); John Lenore & Co. v. Olympia Brewing Co., 550 F.2d 495, 498-99 (9th Cir. 1977). The district court properly instructed the jury on this point. It charged:

> [I]f you find that a conspiracy existed and that it was unlawful, then you must determine whether the conspiracy proximately caused injury to Royal Crown Cola Company, and, if so, the amount of damages.

The court also adopted by reference the following statement from its earlier instructions on appellants' antitrust claims:

> A party is entitled to sue and recover damages under the antitrust laws only if it in fact has suffered a legal injury. . . . A party, to recover, must not only demonstrate by a preponderance of the evidence a violation of the antitrust laws, but also that those violations actually caused injury to the party's business or property.

Because the jury was properly instructed that it could not return a verdict in Royal Crown's favor without finding that appellants' alleged violations of the antitrust laws proximately caused Royal Crown some actual injury, there is not reversible error in Royal Crown's and the court's use of the term "nominal damages." The term was used merely as a shorthand expression denoting that Royal Crown had limited its request for damages due to actual injury to a nominal amount; it was not used in the technical legal sense to mean damages awardable without proof of actual injury. The jury is presumed to have followed its instructions, Husky Refining Co. v. Barnes, 119 F.2d 715, 717 (9th Cir. 1941), and under the instructions in this case, the jury had to find that Royal Crown was actually injured by appellants' antitrust violations before it returned a verdict in any amount for Royal Crown.

Appellants also contend that Royal Crown's counterclaims must be remanded for a new trial because their antitrust claims must be retried. Because we have rejected each of appellants' assignments of error in regard to their antitrust claims, see Part II supra, we must also reject this contention.

AFFIRMED.

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13/ In support of this contention, appellants rely on two statements to the jury. The first was made by counsel for Royal Crown in closing argument:

> We are only asking for nominal damages just to emphasize the point, and his Honor will advise you, we have limited our request to $500 per party, and his Honor will instruct you that is the maximum that can be awarded.

The other statement appellants rely on is one of the court's instructions to the jury.

> Here, however, Royal Crown Cola Company seeks only nominal damages of $500 from the plaintiffs. Even if you find that Royal Crown Cola Company's damages are more than $500, you may not award a greater amount.

--End of Section G--

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ANSWERS TO QUESTIONS SUBMITTED TO CARTHA D. DELOACH, VICE PRESIDENT, CORPORATE AFFAIRS, PEPSICO, BY CHAIRMAN PETER W. RODINO, JR. ON MARCH 27, 1980

1. How many Pepsi bottlers are owned or controlled by multiplant bottlers, corporations not engaged primarily in the production of soft drinks, or Pepsi? What percentage of bottled and canned soft drinks whose syrup is produced by Pepsi are sold through bottlers owned or controlled by multiplant bottlers, corporations not engaged primarily in the production of soft drinks, or Pepsi? What percentage of Pepsi's total canned or bottled soft drinks sales is controlled by bottlers, with a sales volume under $500,000?

   There are approximately fifty family or corporate enterprises which own and operate more than one Pepsi-Cola bottling plant. The bottling plants owned by these family and corporate enterprises account for approximately 70% of the total 1979 sales in the United States of bottled and canned Pepsi-Cola products. Of the fifty enterprises referred to above, there are six corporations, including PepsiCo, which either are owned or controlled by corporations not engaged primarily in the production of soft drinks, or do not themselves engage primarily in the production of soft drinks. For purposes of this question, I have defined a "corporation not engaged primarily in the production of soft drinks" as one which derives more than 50% of its revenues from non-soft drink products. These six corporations account for approximately 36% of the 1979 sales of bottled and canned Pepsi-Cola products.

   PepsiCo does not monitor the dollar sales volume of its bottlers and therefore is unable to supply any detailed information regarding the sales of bottlers having a volume under $500,000.

2. Do your bottlers have a right of first refusal on new products produced by the Pepsi-Cola Company? If your bottler refused your new product would you offer that product to a bottler with a competing cola?

   Pepsi-Cola bottlers do not have a contractual right of first refusal on new products produced by PepsiCo. PepsiCo, however, has not offered new products to non-Pepsi-Cola bottlers in the past. Thus, if a bottler refused a new product, PepsiCo, in accordance with past practice, would not offer that product to a bottler with a competing cola.

3. How many Pepsi bottlers are there today? Has Pepsi prepared any projections or estimates for the number of bottlers that it will have in 1985 and 1990?

There are 426 Pepsi-Cola bottling appointments currently issued to Pepsi-Cola bottlers. PepsiCo has not prepared any projections or estimates for the number of bottlers that it will have in 1985 and 1990.

4. Does H.R. 3567 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?

H.R. 3567 does not immunize *per se* violations of the antitrust laws. It is difficult to comment on any potential amendment to the bill without seeing the specific wording of such an amendment. We believe, however, that any amendment concerning *per se* violations would confuse the meaning of the bill, since this bill deals only with exclusive territories, which are not *per se* violations of the antitrust laws.

5. Would you please define the following terms from H.R. 3567?

   a) "products of the same general class."

   b) "substantial and effective competition."

   How does "substantial and effective" competition differ from competition?

The term "products of the same general class" is designed to give the courts flexibility in determining the range of products with which soft drinks compete in particular geographic markets. We do not know which products would be determined by a court to be products of the same general class and do not believe that either we or the Congress should make that determination. This bill would permit judges and juries to take into account changing marketplace and competitive conditions and changing consumer preferences, rather than be bound by an arbitrary and perhaps outdated list of products.

As with "products of the same general class," the term "substantial and effective" competition is not susceptible to a simple formula but must be determined

on a case-by-case basis. The factors which might be considered in making such a determination were summarized in the report of the Senate Judiciary Committee on S.3421 in the 94th Congress and include the number of brands, types and flavors available, number of retail price options, degree of service competition, ease of entry, number and strength of sellers of competing products, and similar other factors.

Whether competition in a particular market constitutes "substantial and effective" competition is, therefore, a question of fact. It is impossible to determine in isolation when and under what circumstances competition might exist, but might not be "substantial and effective".

6. Are you aware of any studies that discuss size requirements to operate a bottling operation efficiently, either with or without the present system of territorial restraints, in the soft drink industry? If so, provide us with copies of the studies or their citations.

I am not aware of any published study discussing size requirements to operate a bottling operation efficiently.

7. Please provide us with a definition of "soft drinks". How does this definition differ, if at all, from the definition of the term "trademarked soft drink product" in H.R. 3567? Does the term "trademarked soft drink product" include syrups sold by themselves?

A definition of "soft drink" was proposed by NSDA to the Subcommittee in the February 5, 1980 submission by Dwight Reed, President of NSDA. In that submission, NSDA suggested the following definition: "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 products; and (c) drinks based wholly on pure tea, coffee, cocoa, mate, sassafras, bark, buds, leaves and similar plant material."

A "trademarked soft drink product" is a soft drink which is sold under a trademark and includes syrups sold by themselves.

8. Please describe the nature and extent of facilities for producing canned soft drinks owned or controlled by Pepsi. What percentage of the canned Pepsi products sold in the United States are produced by these facilities? What percentage of export sales of canned Pepsi products are produced by these facilities?

Eight Company-owned bottling plants produce canned soft drinks. These facilities produce 15% of the total canned Pepsi-Cola products sold in the United States and 53.8% of the total canned Pepsi-Cola products exported from the United States. Of the exported products, virtually all are sold to United States military operations.

9. Do the licensing agreements with Pepsi bottlers in any way limit the licensee's freedom to market canned or bottled soft drinks in Canada? Mexico? Other markets outside the United States? Does Pepsi take other measures to discourage the export of soft drinks produced by its bottlers?

The PepsiCo licensing agreement appoints a Pepsi-Cola bottler in the United States as PepsiCo's exclusive bottler to manufacture and distribute the trademarked beverage in a specific geographic territory within the United States and nowhere else. PepsiCo discusses with its bottlers the terms and conditions of their bottling appointments. PepsiCo's ability to enforce the territorial provisions in its bottling appointments through the courts is dependent on the outcome of litigation brought by the FTC now pending before the United States Court of Appeals, and on the passage of this bill.

10. Does Pepsi own or control operations for producing canned or bottled soft drinks outside the United States? What percentage of the company's sales of canned or bottled soft drinks outside the United States are produced in facilities owned or controlled by the company?

PepsiCo owns and controls operations for producing canned and bottled soft drinks outside of the United States. Approximately 16% of PepsiCo's sales of canned and bottled soft drinks outside of the United States are produced by facilities owned and controlled by PepsiCo.

11. Please describe briefly the production and marketing system for Pepsi canned and bottled soft drinks in Canada; in Mexico; in the United Kingdom; in the Federal Republic of Germany. How does Pepsi typically produce and market soft drinks for sale in Third World countries? What percentage of sales of soft drinks is in returnable containers in the Canadian market?

PepsiCo appoints independent bottlers throughout the world, including Canada, Mexico, the United Kingdom and the Federal Republic of Germany, to manufacture soft drinks under its trademarks, Pepsi-Cola, Diet Pepsi-Cola, Mirinda "Flavors" and Teem, for distribution in the various territories encompassed under the Bottling Appointment and served by the respective bottler. PepsiCo follows the same procedure in Third World countries.

Approximately 69% of Pepsi-Cola products sold in Canada are sold in returnable containers.

12. What percentage of all sales of canned or bottled soft drinks of your company (including sales for food stores, vending machines and other outlets) are sold in returnable containers? How are these figures altered if the sales of traditionally non-returnable cans or bottles (made returnable only by virtue of State laws such as in Michigan or Oregon) are factored out?

Approximately 37% of all 1979 sales in the United States by Pepsi-Cola bottlers of canned and bottled Pepsi-Cola products were in returnable containers. If sales of cans and non-returnable bottles in Michigan, Oregon, Vermont and Maine are factored out, sales in returnable bottles equal approximately 35.5% of the total 1979 sales.

13. Are there any Pepsi bottlers that do not market returnable bottles for some or all of their soft drink products? How many bottlers? What percentage of total Pepsi sales of canned or bottled soft drinks do these bottlers have?

There are 34 Pepsi-Cola bottlers in the United States which did not sell any returnable containers in 1979, or which sold an insignificant number of returnable containers. These 34 Pepsi-Cola bottlers represent 7.5% of the total 1979 sales of Pepsi-Cola products.

14. Please provide us with copies of your annual statements, and 10-K reports since the FTC case began, and any other material that may be relevant to your relationship with your bottlers.

    Copies of the PepsiCo Annual Report and Form 10-K for the years 1971 - 1979 are available in Subcomittee Files.

15. Please provide copies of studies or documents in your possession indicating the differential between the wholesale prices for soft drinks of your company charged by your various bottlers throughout the country. If no such studies or documents are available, please indicate the range of wholesale prices for canned or bottled soft drinks of your company as sold by your bottlers throughout the United States. If wholesale statistics are not available, please provide any available statistics on price differentials at the retail level.

    PepsiCo does not require its bottlers to report wholesale prices and does not exert any control over the wholesale prices charged by its bottlers. Accordingly, we do not have any systematic, formal studies indicating the differential among the wholesale prices charged by Pepsi-Cola bottlers throughout the country. There may be internal documents referencing wholesale prices of individual bottlers or bottlers in a particular geographic area. Such documents, however, would not give a complete listing of wholesale prices across the United States. Moreover, it would be virtually impossible to provide copies of such documents since a file search of the entire Pepsi-Cola Company operation would be necessary. We are able to provide an approximate range of wholesale prices across the United States for cans: $4.75 - $7.00. This range, however, is only an estimate based on incomplete data and does not take into account seasonal and other fluctuations.

16. Under the proposed legislation, a retailer would be unable to purchase soft drinks outside his territory as he would wish to do when they are cheaper. Why shouldn't a retailer be allowed to purchase at the lowest prices?

    This question is based on an assumption which we believe is false, namely that a retailer would be capable of purchasing soft drinks at a lower price outside his territory. We believe, as I stated in my testimony before the Subcommittee, that exclusive

territories ensure the lowest possible price to the retailer and to the consumer. Even if a bottler in a neighboring territory is charging a lower price, the actual cost to the retailer could be considerably higher, depending on such factors as transportation and labor costs. Moreover, the bottler who is selling extensively to customers outside his territory may experience serious capacity problems, which could drastically affect the economics of his operation, requiring substantial capital investment resulting in higher prices. Finally, as I also pointed out in my testimony, while it is possible that, in the absence of territories, prices may decline in the short run, the elimination of territories will in the long run drive small bottlers out of business and impact the small mom and pop retailers. After the bottler ranks are decimated, the survivors will be able to raise prices higher than ever.

17. The stated fear that "large" bottlers will drive "small" bottlers out of business if this legislation fails enactment is an admission, is it not, that some bottlers are less efficient than others and need legal protection against more efficient, potential competitors? What is the public policy that supports preservation of such inefficiency? Could a legislative scheme be devised to protect returnable containers without sacrificing the gain in efficiency?

This question, like question 16, is based on a false premise, namely that small bottlers are less efficient than large bottlers. Nowhere is there anything in the record developed during the proceedings before the Federal Trade Commission to substantiate this premise. The very real concern that large bottlers will drive small bottlers out of business is based on the likely proximity of large bottlers to warehouses and the likely conversion of those large bottlers to a warehouse system. As I stated in my testimony before the Subcommittee, the ability of large bottlers by virtue of their location and bottling capacity to service large, warehouse accounts will result in those bottlers taking the cream of the business, leaving the smaller bottlers with less profitable accounts. This scenario is not a function of any greater efficiency on the part of large bottlers, but of their geographic proximity to large warehouses and their capacity to service those warehouses.

We do not believe that any legislative scheme can be devised to protect returnable containers. As I stated in my

testimony, a warehouse system is simply not compatible with the use of returnable containers, nor is there any gain in efficiency from a warehouse system.

18. Doesn't this legislation substantially limit interbrand competition as well as intrabrand competition? (How can a Coke bottler in Virginia compete with a Pepsi bottler in Maryland?)

Interbrand competition refers to competition among various brands of products. Pepsi-Cola competes with other soft drinks in a particular market, just as Campbell's Soup competes with Heinz's Soup. In each locality, each brand is represented. This legislation will preserve, not limit, interbrand competition in each market.

19. Proponents of this legislation are asking Congress to codify long-term arrangements which they can claim are beneficial to the public, yet no evidence in support of this claim is provided. For the record, so that the subcommittee might better decide, could you supply us with the average rate of return on equity earned by Pepsi bottlers? Could you further break down that information with respect to small bottlers and large bottlers?

PepsiCo does not normally require the submission of financial information by its bottlers. Hence, the data you have requested regarding the average rate of return on equity by Pepsi-Cola bottlers is not available. I would like to call to the Subcommittee's attention, however, the fact that the record both before this Subcommittee and before Judge Dufresne in the matter of The Coca-Cola Company is replete with evidence of benefits to the public from exclusive territories.

20. The case for this legislation is premised on the thesis that there is substantial interbrand competition today. The fact that today a large quantity of a soft drink sells at the price paid for less efficient quantities sold years ago is not proof of the thesis, since it might be that intrabrand competition would produce even lower prices, as it has for ball point pens and television sets. If this were a court, you would have to prove that there is vigorous interbrand competition in the area involved. In asking for a uniform rule for the entire nation, the same principle should apply. Can you supply proof that the interbrand competition is effective to maintain prices where they would be in the absence of territorial restraints?

Of course, it is impossible to supply factual proof of a purely hypothetical proposition. I would, however, like to bring to the Subcommittee's attention certain findings of fact contained in Judge Dufresne's Initial Decision in the matter of The Coca-Cola Company. Judge Dufresne found that "a short-term or temporary wholesale price reduction might result from wholesale price competition for warehouse delivery of non-returnable containers, but only long enough to force the small bottler out of business and reduce competition." (Initial Decision, p. 67) Moreover, Judge Dufresne concluded that, "even with lower wholesale prices for soft drinks, there is no assurance that the chain stores would pass this reduction on to the consumer in the form of lower prices." As support for this conclusion, he cited several instances in which warehouse delivery of cans to supermarkets did not result in lower retail prices. For example, in the early 1960's, Coca-Cola bottlers in the San Francisco area experimented with warehouse delivery of cans to Safeway, Lucky and Purity stores. Coca-Cola products retailed for the same price as Pepsi-Cola products, despite the fact that the Coca-Cola products were delivered to warehouses while Pepsi-Cola products were delivered directly to the stores. Similar experiments in the 1970's were cited by Judge Dufresne and produced similar results.

21. Occasionally we hear rumors that you have contingency plans to take over certain bottlers if this legislation is not enacted. Are such rumors true? If "yes", could you supply those plans to the subcommittee so that it might assess such a prospect? If "no", would you preclude your bottlers from merging with others?

No, rumors concerning contingency plans to take over certain bottlers are not true. Whether we would approve a change in ownership of any of existing Pepsi-Cola bottling operations would depend on the particular facts of each situation and on whether the prospective purchasers met the terms set forth in PepsiCo's bottling appointments.

22. Since bottlers compete with other bottlers all of whom similarly must make capital investments, why must they be protected from one another? Why does it merit extraordinary treatment?

Soft drink bottlers require "extraordinary treatment" quite simply because the effect on the soft drink industry from the FTC's decision, if that decision is

allowed to stand, would be extraordinary. Exclusive territories have been an integral part of the soft drink industry for the past 80 years and have allowed Pepsi-Cola bottlers to develop successful and vigorously competitive businesses. This attempt by the FTC to restructure an entire industry overnight, thereby destroying 80 years of investment, justifies and indeed requires extraordinary treatment by the Congress.

23. How do you regard the efficiency of warehousing systems like that of C&C?

As I stated in my testimony before the Subcommittee, we believe that the store-door delivery system is the most efficient means of delivering high-quality and low cost soft drink products to the American consumer. A store-door system permits the use of highly efficient returnable packages, which a warehouse system does not. The store-door system also permits the bottler to service a wide variety of retail customers, not just those supermarket chains which operate warehouses, thereby increasing availability and distribution of products. As we have pointed out in response to question 20, there is no evidence in the record to support the proposition that warehouse delivery will lead to lower retail prices; in fact, the available evidence suggests that warehouse delivery may lead to an increase in prices as small bottlers will be forced out of business and price competition decreased. Finally, we believe that the store-door system better services the consumer, by permitting more effective quality control and by encouraging the introduction of new packages and new brands.

24. Are all soft drinks carbonated? If not, do you intend this legislation to apply only to carbonated soft drinks? If so, would you endorse such an amendment?

No, not all soft drinks are carbonated. We do not believe that the legislation should apply only to carbonated soft drinks, nor would we endorse such an amendment.

25. What means of enforcement that are violative of antitrust law does this legislation permit? If none, why is the "enforcement" provision included on page 3, line 2 of H.R. 3567?

This legislation does not permit enforcement in violation of the antitrust laws. The "enforcement" provision in H.R. 3567 refers to enforcement of contract rights contained in trademark licensing agreements. This bill would simply allow the enforcement of such rights to the extent permitted by law.

26. Why should the benefits of this legislation 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? Would you endorse a subcommittee amendment to limit the bill to actual bottlers since the protection of capital investments is the rationale of this legislation?

In a few isolated situations, a bottler may be temporarily out of production. Such situations, however, are of short duration and should not deprive that bottler of the benefits of this legislation. A bottler who is presently not producing soft drinks in all likelihood was producing in the past and will again be producing in the future. Such production requires extensive initial and continuing investment in plant and equipment, glass, trucks and inventory. Accordingly, we would not support an amendment to limit the bill to bottlers actually in production.

27. On page 3, line 10-11, of H.R. 3567, limitations on resale are permitted so that products will be sold to consumers within a given territory. Do these limitations apply to customers of the bottlers? If so, must a syrup manufacturer enforce the limitations only in court or may it also engage in self-enforcement by inducing a boycott of such customers?

If H.R. 3567 is adopted, provisions contained in trademark licensing agreements limiting the licensee to the manufacture, distribution and sale of products for ultimate resale to consumers within a defined geographic area would be permitted, if such products are in substantial and effective competition with other products of the same general class. Such limitations, by the very nature of the trademark licensing agreement, would apply directly to the licensee-bottler. As licensor, a syrup manufacturer could enforce its contract rights to the full extent permitted by the law.

28. Does the territorial franchise system raise prices to the consumer? If not, would you oppose an amendment to this legislation to provide that a particular franchise will be given an exemption for the antitrust laws as long as the arrangement does not artificially increase prices over what they would otherwise be?

We believe, as I stated in my testimony before the Subcommittee, that the territorial system results in the lowest possible price to the consumer. We would oppose any amendment to the legislation relating to prices, since such an amendment would, in our opinion, be totally unworkable.

29. Inasmuch as many years have elapsed since your territorial boundaries were first drawn, have changes in technology, shifting population and improved transportation made these divisions less efficient and economical to serve than if the boundaries were laid out today? Are territorial franchise boundaries ever redrawn in the interest of economy and efficiency?

No, our territories are just as efficient and economical today as they were when they were first established. Exclusive territories have actually allowed bottlers to better adapt to changes in technology, transportation and population within their territories, since they are able to make the necessary investment to meet such challenges. As a result of such investment and the ability to focus their efforts exclusively on one geographic area, bottlers have been able to develop better and more efficient methods of distributing their products and servicing their accounts. The efficiency of product distribution under a store-door delivery system is not a function of either the size of the territory or the length of the route. The widespread support by bottlers for this legislation is visible proof of the continued economic viability and efficiency of our territorial boundaries.

In view of the efficiency of the existing system, there has been no need to redraw territorial boundaries. Of course, from time to time, territories may be consolidated through acquisition. If territories are consolidated, however, the overall perimeters of the combined territories do not change, although the boundary lines which originally separated those territories may be eliminated.

ADDITIONAL QUESTIONS FOR MR. LUCIAN J. SMITH
PAST PRESIDENT COCA-COLA CO.

1. How many Coca Cola bottlers are owned or controlled by multiplant bottlers, corporations not engaged primarily in the production of soft drinks, or Coca Cola?
   What percentage of bottled and canned soft drinks whose syrup is produced by Coca Cola are sold through bottlers owned or controlled by multiplant bottlers, corporations not engaged primarily in the production of soft drinks, or Coca Cola?
   What percentage of Coca Cola's total canned or bottled soft drinks sales is controlled by bottlers, with a sales volume under $500,000?

2. Do your bottlers have a right of first refusal on new products produced by the Coca Cola Company?
   If your bottler refused your new product would you offer that product to a competing bottler? For example, Coca Cola of New York distributes Dr. Pepper. If they refused Mr. Pibb how would Mr. Pibb be introduced in the New York area?

3. How many Coca Cola bottlers are there today?
   Has Coca Cola prepared any projections or estimates for the number of bottlers that it will have in 1985 and 1990?

4. Does H.R. 3567 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?

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5. Would you please define the following terms from H.R. 3567?

    a) "products of the same general class."

    b) "substantial and effective competition".

    How does " substantial and effective" competition differ from competition?

6. Are you aware of any studies that discuss size requirements to operate a bottling operation efficiently, either with or without the present system of territorial restraints, in the soft drink industry? If so, provide us with copies of the studies or their citations.

7. Please provide us with a definition of "soft drinks". How does this definition differ, if at all, from the definition of the term "trademarked soft drink product" in H.R. 3567? Does the term "trademarked soft drink product" include syrups sold by themselves?

8. Please describe the nature and extent of facilities for producing canned soft drinks owned or controlled by Coca Cola. What percentage of the canned Coca Cola products sold in the United States are produced by these facilities? What percentage of export sales of canned Coca Cola products are produced by these facilities?

9. Do the licensing agreements with Coca Cola bottlers in any way limit the licensee's freedom to market canned or bottled soft drinks in Canada? Mexico? Other markets outside the United States? Does Coca Cola take other measures to discourage the export of soft drinks produced by its bottlers?

10. Does Coca Cola own or control operations for producing canned or bottled soft drinks outside the United States? What percentage of the company's sales of canned or bottled soft drinks outside the United States are produced in facilities owned or controlled by the company?

11. Please describe briefly the production and marketing system for Coca Cola canned and bottled soft drinks in Canada; in Mexico; in the United Kingdom; in the Federal Republic of Germany. How does Coca Cola typically produce and market soft drinks for sale in Third World countries? What percentage of sales of soft drinks is in returnable containers in the Canadian market?

12. What percentage of all sales of canned or bottled soft drinks of your company (including sales for food stores, vending machines and other outlets) are sold in returnable containers? How are these figures altered if the sales of traditionally non-returnable cans or bottles (made returnable only by virtue of State laws such as in Michigan or Oregon) are factored out?

13. Are there any Coca Cola bottlers that do not market returnable bottles for some or all of their soft drink products? How many bottlers? What percentage of total Coca Cola sales of canned or bottled soft drinks do these bottlers have?
14. Please provide us with copies of your annual statements, and 10-K reports since the FTC case began, and any other material that may be relevant to your relationship with your bottlers.

15. Please provide copies of studies or documents in your possession indicating the differential between the wholesale prices for soft drinks of your company charged by your various bottlers throughout the country. If no such studies or documents are available, please indicate the range of wholesale prices for canned or bottled soft drinks of your company as sold by your bottlers throughout the United States. If wholesale statistics are not available, please provide any available statistics on price differentials at the retail level.
16. Under the proposed legislation, a retailer would be unable to purchase soft drinks outside his territory as he would wish to do when they are cheaper. Why shouldn't a retailer be allowed to purchase at the lowest prices?
17. The stated fear that "large" bottlers will drive "small" bottlers out of business if this legislation fails enactment is an admission, is it not, that some bottlers are less efficient than others and need legal protection against more efficient, potential competitors? What is the public policy that supports preservation of such inefficiency? Could a legislative scheme be devised to protect returnable containers without sacrificing the gain in efficiency?

18. Doesn't this legislation substantially limit interbrand competition as well as intrabrand competition? (How can a Coke bottler in Virginia compete with a Pepsi bottler in Maryland?)

19. Proponents of this legislation are asking Congress to codify long-term arrangements which they can claim are beneficial to the public, yet no evidence in support of this claim is provided. For the record, so that the subcommittee might better decide, could you supply us with the average rate of return on equity earned by Coca Cola bottlers? Could you further break down that information with respect to small bottlers and large bottlers?

20. The case for this legislation is premised on the thesis that there is substantial interbrand competition today. The fact that today a large quantity of a soft drink sells at the price paid for less efficient quantities sold years ago is not proof of the thesis, since it might be that intrabrand competition would produce even lower prices, as it has for ball point pens and television sets. If this were a court, you would have to prove that there is vigorous interbrand competition in the area involved. In asking for a uniform rule for the entire nation, the same principle should apply. Can you supply proof that the interbrand competition is effective to maintain prices where they would be in the absence of territorial restraints?

21. Occasionally we hear rumors that you have contingency plans to take over certain bottlers if this legislation is not enacted. Are such rumors true? If "yes," could you supply those plans to the subcommittee so that it might assess such a prospect? If "no," would you preclude your bottlers from merging with others?

22. Since bottlers compete with other bottlers all of whom similarly must make capital investments, why must they be protected from one another? Why does it merit extraordinary treatment?

23. How do you regard the efficiency of warehousing systems like that of C & C?

24. Are all soft drinks carbonated? If not, do you intend this legislation to apply only to carbonated soft drinks? If so, would you endorse such an amendment?

25. What means of enforcement that are violative of antitrust law does this legislation permit? If none, why is the "enforcement" provision included on page 3, line 2 of H.R. 3567?

26. Why should the benefits of this legislation 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? Would you endorse a subcommittee amendment to limit the bill to actual bottlers since the protection of capital investments is the rationale of this legislation?

27. On page 3, lines 10-11, of H.R. 3567, limitations on resale are permitted so that products will be sold to consumers within a given territory. Do these limitations apply to customers of the bottlers? If so, must a syrup manufacturer enforce the limitations only in court or may it also engage in self-enforcement by inducing a boycott of such customers?

28. Does the territorial franchise system raise prices to the consumer? If not, would you oppose an amendment to this legislation to provide that a particular franchise will be given an exemption for the antitrust laws as long as the arrangement does not artificially increase prices over what they would otherwise be?

29. Inasmuch as many years have elapsed since your territorial boundaries were first drawn, have changes in technology, shifting population and improved transportation made these division less efficient and economical to serve than if the boundaries were laid out today? Are territorial franchise boundaries ever redrawn in the interest of economy and efficiency?

1. Five Coca-Cola bottlers are not primarily engaged in the production of soft drink products. They account for 8.1% of domestic unit sales of Coca-Cola products in bottles and cans.

The Company does not maintain a record of bottlers with more than one production location.

There are about 50 Coca-Cola bottlers whose annual sales are less than $500,000. These bottlers account for less than 1% of the domestic sales volume of Company products in bottles and cans.

2. Our bottlers do not have a right of first refusal for our Allied brands. However, in the past, The Coca-Cola Company unilaterally has followed the practice of not offering its Allied brands to any bottlers other than its franchised Coca-Cola bottlers. Coca-Cola bottlers are not required to carry any other brands licensed by The Coca-Cola Company. Many have decided not to handle some other brands and have instead obtained exclusive trademark licenses to manufacture and sell competing brands of other licensors in their territories.

3. Today there are approximately 550 Coca-Cola bottlers in the United States.

We do not know how many there will be in 1985 or 1990. However, if present trends continue, we are reasonably certain that as a result of the ongoing uncertainty about the ultimate outcome of the appeals in the Federal Trade Commission case -- a process which should continue for years unless H.R. 3567 quickly becomes law -- there will be fewer bottlers of Coca-Cola in 1985 than there are today.

4. The bill does not, and was not intended to, immunize any *per se* violations of the antitrust laws as that doctrine is normally applied by the courts. The bill does serve to clarify at once that the Federal Trade Commission improperly applied § 5 of the Federal Trade Commission Act to hold illegal trademark licenses between The Coca-Cola Company and hundreds of independent bottlers which had been held legal by federal courts under the antitrust laws for the last 60 years and are still clearly procompetitive and legal under the law and policies set forth recently by the Supreme Court in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977) but ignored by the two-member Commission majority.

It is impossible to comment on an amendment designed to clarify that the bill does not immunize *per se* conduct in the abstract without analyzing the actual language of such suggested amendment. No such proviso appears in any other statute and we believe that attempts to insert this concept will in all likelihood cause more problems than it would solve.

5(a) It is impossible to define precisely at this time for purposes of prospective application in lawsuits under the proposed statute the meaning of the term "products of the same general class". As is common in antitrust litigation in defining a "product market", it will be the function of the trier of fact to apply this term in a given case at a given time depending upon the evidence of market dynamics.

This broadly phrased term clearly means to include more than just carbonated flavored soft drink products. The bill itself refers generally to license agreements for a "trademarked soft drink product" without further limitation or qualification.

Particularly in the last few decades, the soft drink industry has been characterized by rapid proliferation of competition in price, packaging, availability, advertising, and store display from new types of products -- such as canned iced teas, powdered mixes, fruit drinks and isotonic drinks -- and more direct competition from established products -- such as fruit juices, milk, bottled waters and post-mix syrups.

The franchise bottler system itself, for example, produces more than carbonated soft drinks. The major canned iced tea brands -- Lipton and Nestea -- became significant competitors nationally only after piggybacking on the established bottler system. Licensed bottlers also manufacture and distribute fruit juice drinks and post-mix syrups.

The Commission Majority found Coca-Cola to be closely price sensitive not only to other national, regional and local brands of carbonated soft drink products of various flavors, but also to non-carbonated drinks such as canned iced tea and fruit juices, and to powdered mixes. The Commission stated that "... the suppliers of hundreds of other interbrand soft drink products must be responsive to the prices of Coca-Cola and the allied products..." (Majority Opinion, pp. 50-52).

5(b) "Substantial and effective competition" is also a phrase designed to give flexibility in determining whether interbrand competition among trademarked soft drink products is economically significant in a particular situation.

There is no set formula that can be used in making such a determination, but the recent Report of the Senate Judiciary Committee on S.598 lists some of the factors that would normally be taken into consideration and balanced by the trier of fact:

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

The bill clarifies that the social and economic analysis used by the Supreme Court in Continental T.V., Inc. v. GTE Sylvania, supra, for applying a rule of reason anaylsis to vertical restraints generally is to be specifically applied as a matter of public policy to the exclusive territorial provisions used in trademark licenses in the soft drink industry. Thus, the decision of the Federal Trade Commission, contrary to the teachings of GTE Sylvania, to give preeminence as a matter of policy under §5 to the loss of some intrabrand competition over the existence of vigorous interbrand competition will be made to conform without further delay to the national antitrust policies set forth by the Supreme Court. As stated in the recent report of the Senate Judiciary Committee:

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

The phrase "substantial and effective" is used to modify the term "competitive" only to signify that a traditional analysis of the competitive dynamics of the interbrand market is required, and not merely a determination that some competition exists among different brands.

6. I am unaware of any studies that discuss size requirements to operate a bottler efficiently. It is my own belief that bottler size is no guarantee of efficiency. Experience shows that small bottlers are often more cost-efficient and more effective competitors than large bottlers.

For example, smaller bottlers tend to have higher per capita unit sales than larger bottlers of the same brand in the same region. Even the Commission Majority made lengthy findings that both large and small bottlers had adapted to changing technological and marketing demands (Majority Opinion at 22-23). Furthermore, it found that production efficiencies or economics of scale in the bottling business are not substantial between large and small bottlers, that the price levels of small bottlers of Coca-Cola are about the same or lower than those of large bottlers, and that small bottlers have been able to compete price wise on a head-to-head basis under the current route delivery system in the interbrand market against large bottlers of competing national brands. (Majority Opinion at 67-69).

7. We agree with the following definition of soft drinks which was provided by the National Soft Drink Association to the Hon. Peter W. Rodino, Jr. by letter of January 22, 1980.

> 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, mate, sassafras, bark, buds, leaves, and similar plant material.

A "trademarked soft drink product" is a soft drink product which has the protection of a trademark. We do not know of any soft drink product which is not trademarked.

It is our understanding that drafters of the Bill intended "trademarked soft drink products" to include syrups sold by themselves.

8. The Coca-Cola Company owns and operates plants which manufacture canned Coca-Cola and Allied products at the following locations:

College Park, Georgia
Baltimore, Maryland
Nashua, New Hampshire
Alsip, Illinois
Columbus, Ohio
San Leandro, California
Bellevue, Washington

Those facilities produce about 13% of Company products sold in cans in the United States. Those facilities produce less than 5% of Company products sold in cans outside the United States.

9. Each contract between The Coca-Cola Company and each Coca-Cola bottler in the United States licenses the bottler to manufacture and distribute a trademarked soft drink product of the Company in a specifically defined geographic territory in the United States. None of these territories overlaps into Mexico, Canada or elsewhere outside the United States. As stated in response to Question 11, The Coca-Cola Company has granted similar exclusive trademark licenses to manufacture and sell its soft drink products in defined geographic territories to local bottlers in over 135 countries.

10. Yes. The Company owns or controls operations for producing canned and bottled soft drinks outside the United States. Those operations produce about 11.5% of canned or bottled Company soft drinks sold outside the United States.

11. The Coca-Cola Company markets its soft drink products in 135 countries worldwide. In each country, the Company has chosen the franchise system, which encourages local indigenous bottlers to invest in the business. This basic philosophy equally applies in Third World countries.

In the Canadian market 60.7% of Company soft drink products are sold in returnable containers.

12. We estimate that about 40% of the total domestic sales volume of all Company soft drinks sold in cans or bottles are sold in returnable containers. Factoring out traditionally non-returnable cans or bottles would reduce this percentage by 1-2 point(s).

13. So far as the Company knows, all Coca-Cola bottlers use returnable bottles for some or all of their soft drink products, with the exception of four bottlers in Alaska.

14. The Coca-Cola Company's 10-K reports since 1971 are available in Subcomittee Files. Included in each 10-K is the annual statement.

15. The Coca-Cola Company does not request from its bottlers, nor does it have, records or documents which disclose bottler wholesale list prices or sales prices. The Company believes that such prices vary significantly from day to day from package to package among territories in response to local competitive conditions, unlike the situation with most branded food products which are usually manufactured by a single company nationwide.

Attached are lists of average retail prices, by package type, for a statistical case (192 ounces) of Coca-Cola and for all Company products consumed in the home in seven areas of the United States derived from surveys used by the Company.

It should be noted that retail prices for Coca-Cola may vary widely on any given day in any bottler's territory on a given package. This occurs because of the substantial number of ongoing price promotions engaged in by bottlers of Coca-Cola and the practice of some food chains not to participate in some promotions that harm their sales of private label soft drinks.

The attached retail price statistics do indicate, as previously found by the Administrative Law Judge and the Commission (Majority Opinion at 55, n.49; IDF Nos. 123, 126; RPF Nos. 207, 209-211), that Coca-Cola in returnable bottles still continues to be priced at retail substantially below the price of Coca-Cola in cans and one-way bottles. As shown, in some regions it is less than half the price on a per ounce basis. This is particularly interesting since food chains, as a matter of policy, take a higher profit on Coca-Cola in returnables than on Coca-Cola sold in disposable packages and often refuse to price-promote returnables even when wholesale price-promotions are offered by the bottler. (RPF Nos. 132, 134-137, 141-145).

COCA-COLA

	Cans	One-Way Bottle	Returnables
Eastern	4.10	2.82	2.45
Mid East	4.07	3.01	2.04
Central	3.84	2.88	1.86
Western	3.60	2.80	2.24
Southwest	3.77	2.90	1.95
Mid South	3.96	2.82	2.06
Southeast	3.81	2.92	1.92

ALL COCA-COLA SOFT DRINK PRODUCTS

	Cans	One-Way Bottle	Returnables
Eastern	4.06	2.80	2.46
Mid East	4.06	3.00	2.02
Central	3.93	2.88	1.85
Western	3.65	2.99	2.20
Southwest	3.71	2.89	1.89
Mid South	4.05	2.88	2.07
Southeast	3.93	2.94	1.94

16. Implicit in these questions are a number of assumptions with which I strongly disagree. The question assumes that momentary evidence of different prices on a product in continguous territories is _prima facie_ evidence of an uncompetitive market. It also implies that government intervention and regulation is somehow superior to allowing competition to operate in a free market economy. These same assumptions represent the fundamental analytical errors in the decision of the Federal Trade Commission and the source of its conflict with national antitrust policy as expressed in _GTE-Sylvania_ by the Supreme Court. These points are discussed in detail in the _Reply Brief of Petitioners The Coca-Cola Company, et al._ filed with the Court of Appeals for the District of Columbia. I would suggest the Committee review that brief, a copy of which has been supplied to the Committee staff. But let me summarize what is argued therein.

It is meaningless to contend that the exclusive territorial system is "anticompetitive" because on a given day a retail customer located in bottler A's territory could otherwise drive a truck one hundred miles into bottler B's territory and buy one type of Coca-Cola package at a lower price than he could from bottler A.

In an industry which is extremely competitive and where manufacturing and distribution of a national brand trademarked item, like soft drinks, has been decentralized into the hands of local businessmen, one would assume that local competitive conditions would result in widely varying price, packaging and distribution strategies among such licensees of any particular brand, just as it would lead to differences in competitive strategies with suppliers of other brands in the same territory.

This may be a hard concept to grasp, as it obviously was for two members of the Federal Trade Commission, because there is virtually <u>no intrabrand</u> competition at the manufacturing level in any other product sold to retail food stores in the United States, or to almost any retail stores selling any branded products. No food retailer can drive his truck into the next county in order to get a better price from a second manufacturer of a particular brand of canned peas. There is no "second manufacturer." No one, for example, can go to an alternative manufacturer of Minute Maid Orange Juice to get a lower price than that charged by The Coca-Cola Company, whose "exclusive territory" for Minute Maid is the world. This is the prevailing manufacturing and distribution pattern throughout the food industry and most other manufacturing industries. But there is inherently nothing wrong with either method of distribution that justifies government interference to force use of one method over the other.

All methods businessmen use to compete in a free enterprise system are imperfect in their responses to a wide array of conflicting demands in the marketplace. Competitive markets in the real world are not static--with identical prices, products and methods of distribution. They are in constant flux and reflect differing competitive strategies--a pattern prevalent in the soft drink industry.

The long-standing policy of our Antitrust laws, confirmed in Sylvania, is to presume noninterference with private decision-making unless a contractual restraint is proven to have an anticompetitive impact so substantial that it is unchecked by competitive forces in the overall market. Competitive decisions are made by competing businessmen pressured by a free market. If they are wrong, it is reflected in sales and profit figures. The competitive activities of The Coca-Cola Company and its bottlers are tested everyday in the marketplace, and have been for eighty years, by an increasing number of competitors with various competitive strategies.

As a result of the territorial system, competitive conditions in the soft drink industry, in any local region, are uniquely and intensely competitive, as found by the Administrative Law Judge and everyone who has judged the industry in litigation with the exception of two members of the Federal Trade Commission.

We submit that the question has been posed the wrong way. The important question is whether retailers and consumers have substantial alternatives in the actual marketplace of interbrand competition which serve to competitively check the

prices of any bottlers, including the bottler of Coca-Cola, from being artificially high--in other words, evidence of strong competition in the interbrand market based upon the traditional indicia of competition such as number of competitors, market structure, changes in market shares, trends to concentration, ease of entry, pricing patterns over time, price cutting, product innovation, quality control, varying types of distribution systems, product availability, service and so forth. I suggest the Committee review pp. 19-23 in our Reply Brief for a record summary of such evidence in the soft drink industry, as well as the excellent summary of such evidence in the Senate Judiciary Committee Report on S.598. As that Report concluded:

> "In the Committee's opinion, the FTC's decision does not reflect either the numerous findings of the Administrative Law Judge concerning the existence of 'intense' interbrand competition or the Supreme Court's admonition in Sylvania that '(i)nterbrand competition... is the primary concern of Antitrust law.' "

The question also assumes that if the territorial system is banned, retailers will be able to purchase soft drinks at lower prices than exist today. I believe that the banning of soft drink territories will have the opposite effect. It will lead to bottler concentration, eventual disappearance of the returnable bottle, and higher prices for the consumer.

As explained several times in my testimony, the loss of territories will cause chains to switch to a warehouse delivery system which can only accommodate one-way packages. The chains will give their high volume one-way business to relatively

few bottlers. This means that many bottlers will lose their high-volume chain store business. The bottler who loses this business will have to cover his costs with a reduced volume of returnable containers. To do this, he will have to raise his prices on returnable containers to a point where they will approach the price of one-way containers. When this happens, the returnable bottle will disappear from the market. This will occur notwithstanding an FTC order which would permit the continuation of territories for returnable containers.

I believe that the concentration of high-volume chain store business in the hands of relatively few bottlers will raise the costs of many bottlers to the point where they will not be able to effectively compete. This will force them out of the bottling business. As the bottling business becomes more concentrated, the price of soft drinks will rise, availability will deteriorate, and the number and variety of packages and products will diminish. Ultimately, the consumer will be left with no choice but the higher-priced, one-way container.

This same scenario was accurately set forth by the Administrative Law Judge and by the Senate Judiciary Committee which reviewed the record evidence in detail in its Report, concluding:

> "The Committee believes that the Judge correctly described the probable effects of elimination of territories...
>
> Regardless of the short term effects of the elimination of territories the Committee believes that within a few years the soft drink industry would become concentrated in the hands of a few, extremely large, regional soft drink bottlers. These few surviving bottlers would raise wholesale prices to all customers including food chains. Consequently, retail

prices to consumers would increase. Simultaneously, the surviving bottlers will offer fewer brands in fewer types of packages to significantly fewer accounts than are presently served. The Committee therefore believes that the public policy stated in the Antitrust laws would be better served by retention of the existing competitive structure of the soft drink industry under the standards of this bill."

In sum, I strongly disagree with those that say H.R. 3567 will interfere with free market competition and limit price competition. To the contrary, it will ensure such competition continues. It is the decision of the Federal Trade Commission that is already leading to rapid industry concentration and which, if ultimately upheld, will interfere with the workings of the free market and result in higher overall prices to the consumer.

17. First, as I stated in response to Question 6, large bottlers have not been shown to be more "efficient" than smaller bottlers. If anything, available evidence would indicate smaller bottlers generally are stronger competitors than large corporate bottlers in head-to-head competition in existing territories.

But all bottlers of Coca-Cola, whether large or small, are competitively "efficient" relative to their competitors because of the use of territorial restraints. If they were not, Shasta--which is manufactured and distributed nationally by a huge food conglomerate--would be outselling Coca-Cola in the markets of at least a few of those small "inefficient" bottlers. But it never has--not even in the limited universe of chain and other warehouse supplied outlets in which it competes.

Bottlers will be driven out of business by the hundreds without exclusive territories not resulting from any inefficiency on their part, but because they will not be able to compete with a relative handful of large bottlers of Coca-Cola for large volume sales of cans and one-way bottles to food chain warehouses.

The FTC decision would radically restructure demand forces in the marketplace and burden most bottlers of Coca-Cola with sudden artificial disadvantages. Most bottlers do not have the financial resources to compete in sustained price wars with the largest bottlers of Coca-Cola, some of which are publicly-traded companies. Most bottlers do not even own facilities to manufacture Coca-Cola in cans--the key competitive

package in the FTC's "new world"--but rather would have to be supplied canned products by their new competitors. Such bottlers, with no canning facilities, no deep pocket of financial resources and competing with their own suppliers for sales to warehouses invariably located in the territories of such suppliers will be out of business virtually overnight.

Second, I make no request that this Committee support this legislation to protect smaller bottlers because they are allegedly inefficient. They are not inefficient. But efficient or not, it has been one of the paramount purposes of public policy expressed in the Antitrust laws to preserve a society composed of small, local business units--both to protect the social values embodied in such an economic structure and to carry out our national conviction that the decentralization of economic power, in the long-run, will generate the highest quality of goods at the lowest prices for the largest number of people. The soft drink industry represents an almost unique instance in which this ideal of industrial decentralization has been achieved in a major American industry. And the results, as predicted, have been substantial growth in production and incredibly low prices relative to rapid and substantial price increases in other more centralized industries.

Third, no legislative scheme will save the returnable bottle. There has never been any evidence, presented to the Congress or at the FTC trial, to explain how the returnable bottle would survive the loss of exclusive territories on cans and one-way bottles. The Commission Majority's a priori

assumption that its Order, which continues to allow exclusivity for returnables, will be in some unexplained manner "save returnables" is ridiculous. The Commission's trial staff, in seven years of litigation, never suggested this form of Order be entered. The Commission itself found that, under its Order, the prices of all Coca-Cola sold to non-warehouse accounts would rise with the removal of territorial restrictions--the sure death knell of the returnable since it also determined returnables would never be warehoused and that the returnables' only competitive advantage was its relatively low price. In reviewing the record evidence, the Senate Judiciary Committee Report on S.596 dismisses the Commission's fantasy in this regard:

> "The Administrative Law Judge found that '(i)f the chain stores converted to a system of warehouse delivery, the chain stores would eliminate returnable bottles entirely because the returnable bottle is incompatible with warehouse delivery.' This incompatibility results from the facts that returnable bottles involve extra handling costs and compete vigorously in price with the private label soft drinks sold by the food chains (which are sold almost entirely in non-returnable containers). If the food chains do eliminate returnable bottles when they adopt a warehouse delivery system for soft drinks the cost of delivering returnables to other customers will increase dramatically. The Committee believes that the ultimate result will be the abandonment of the route delivery system and, therefore, the demise of the returnable bottle."

There should be no misunderstanding that if H.R. 3567 is not passed and the Commission's Order stands, the returnable bottle will be as dead as the hundreds of bottlers that will go down with it. And later recriminations by consumers and their legislative representatives will not resurrect it or the low prices at which it sold.

18. No. It is no more logical to conclude that territorial restraints "limit" interbrand competition because a Coca-Cola bottler in Virginia cannot compete against a Pepsi-Cola bottler in Maryland than to say competition is limited because the same Coca-Cola bottler cannot compete with a Pepsi-Cola bottler in West Germany. This alleged "effect" is inherent in the use of all territorial restraints and is so competitively meaningless in itself it has, to our knowledge, never been relied upon by a Court in an antitrust case until this argument was weakly made by the Commission Majority in the Coca-Cola case. It certainly did not bother the Court in Sylvania, where the plaintiff's Sacramento store was unable to engage in "interbrand competition" as a result of that restraint with thousands of other retail television stores throughout the United States.

The competitive significance of such a "loss", if any, can be gauged only by a complete market study including analysis of the strength of actual price, availability, service, quality and packaging competition existing in the relevant market of all suppliers. The point is more completely discussed in our Reply Brief at pp. 15-16.

As shown in the record of the FTC case, the level of interbrand competition is intense in every local market, whether large of small, urban or rural, in whatever part of the country. See Reply Brief, pp. 19-23. As stated by the Senate Judicial Committee in its Report on S.598:

> "The specific findings of the Judge revealed a highly competitive industry whose competitiveness was largely caused by the territorial provisions."

19. I take exception to the assertion in this question that there is "no evidence" to support the claim that the exclusive territorial provisions in the trademark licenses for Coca-Cola "... are beneficial to the public." The Committee has access to the entire trial record in the FTC case and many of the pleadings and briefs have been given to the Committee. The focal issue at that lengthy trial was the effect on competition attributable to such restraints and the resultant benefits or harm to the public. It was one of the longest and most detailed trials in antitrust history involving a full rule of reason evidentiary analysis of the effects of the use of territorial restraints in a major industry.

The Commission staff has been given the Joint Brief of Petitioners The Coca-Cola Company, et al. filed with the Court of Appeals. I would suggest the Committee review pp. 34-85 of that brief and the record evidence cited therein in order that it can determine, as has the Senate Judiciary Committee, that territorial exclusivity has benefitted the public in myriad ways, including providing the highest quality products at low prices at more retail outlets than virtually any other product sold in American commerce. I am also attaching herewith a copy of the Proposed Findings of Fact (RPF) submitted post-trial to the Administrative Law Judge. The Committee may wish to review Findings 63 through 360 and the detailed Record references cited therein.

Based on a 1978 sample of about 100 participating Coca-Cola bottlers, the average rate of return on capital used in the business (net operating profit/total capital used in the business) is 12.6. While we cannot give a breakdown by large and small bottler, we can give the following breakdown:

Under 1 million cases	1-2 million cases	2-5 million cases	5 million + cases
12.5%	15.3%	11.2%	11.7%

The undisputed evidence in the trial before the Federal Trade Commission was that 85% of all Coca-Cola plants have fewer than 100 employees. These plants would be classified as small businesses according to the Small Business Administration definition.

20. Based on long experience in the soft drink business, I can confidently predict that if territories are banned, soft drink prices will shortly be higher than they would be if the territorial system is maintained. As explained in greater detail in my answer to Question 16, the banning of soft drink territories will eliminate many bottlers from the soft drink business, result in bottler concentration, eventual disappearance of the returnable bottle and higher prices for the consumer on all remaining packages. The Commission Majority itself found that warehouse delivery to food chains would lead to higher costs and higher prices to all accounts other than food chains (Majority Opinion at pp. 31-32 and n.31) -- i.e., higher prices to retailers presently selling more than 75% of all Coca-Cola in bottles and cans (RPF No. 325).

It also should be noted there is a variety of undisputed evidence to establish the existence of substantial interbrand competition. The record evidence introduced during the trial at the Federal Trade Commission was overwhelming in showing how vigorous interbrand competition is in the soft drink industry. This evidence is summarized at pp. 19-23 of the Reply Brief and detailed in RPF Nos. 156-278. Further evidence that competition in the interbrand market already serves to check the prices of Coca-Cola is the Federal Trade Commission's own finding that the price competition between Coca-Cola and other national, regional and local brands of all flavors, including non-carbonated beverages, has resulted in a cross-elasticity where price differences of only one cent

per six-pack at retail affect sales volume. (Majority Opinion at pp. 51-52.) This is the strongest evidence imaginable of a vigorously price competitive market.

I am puzzled by the question's reference to lower prices allegedly resulting from intrabrand competition in ball point pens and television sets by way of comparison to the soft drink industry since I am unaware that intrabrand competition exists in those industries at the manufacturing level. At the retail level, there is probably more intrabrand price competition in Coca-Cola -- which is sold at over one million retail outlets -- than any other branded product in America. And such widespread distribution is a function of the route delivery system. In any event, the performance of Coca-Cola pricing over the last seventy years relative to any type of historical pricing index for all products establishes how remarkably low the price of Coca-Cola is today.

21. No. The rumors are not true.

While we have no predisposition against consolidation of bottler territories through mergers, we would want to consider the merits of each proposed consolidation.

22. The purpose of H.R. 3567 is not to arbitrarily protect one bottler from another. All bottlers of Coca-Cola are forced to compete in the interbrand marketplace with numerous suppliers already. (See IDF Nos. 92, 163-166; RPF Nos. 157-169, 173-185, 254-264, 268-278; Joint Brief, p. 72, n.100). Its purpose is to preserve the territorial system which has led to wide product availability and low prices for the consumer, particularly as represented by the returnable bottle. I submit that there would not have been these phenomenal results without territories which have encouraged the bottlers to make substantial investment in plant and equipment.

This point is particularly true as it relates to returnable containers. Every tribunal who has looked at the question, including the FTC, has conceded that territories are necessary for returnable bottles. The reason is very straightforward. Without them, the bottler would lose his sizable investment in returnable glass. Further, the returnable package will disappear unless territories are maintained for one-way containers. (See answers to Questions 16 and 17).

I would like to make one final point. I don't believe that H.R. 3567 gives "extraordinary treatment" to the bottling business. To the contrary, H.R. 3567 does nothing more than confirm and clarify the standard for judging the legality of a manufacturing, marketing and distribution system that has been in existence for eighty years. The only example of "extraordinary treatment" is the prospective intervention of the Federal Trade Commission into the workings of the free marketplace in the soft drink industry. The Commission's decision, even while on appeal, is already seriously curtailing capital investment and leading to unnecessary consolidations and mergers.

23. In 1975, a comparative analysis of the cost efficiencies of the warehouse delivery system and the store door delivery system was conducted.

The cost analysis included a detailed examination of each step in the distribution process in both systems. Among other things, there was an examination of the cost of (a) the movement of product from a manufacturing location to a warehouse location, (b) the unloading in the warehouse, (c) the storing, (d) the assembling of orders to go to a particular store (where a dolly is pulled from bin to bin and items are picked off and assembled for a specific store), (e) the outloading of an order onto a truck, (f) the movement of product from warehouse to the store itself, (g) the unloading in the store, (h) the receiving, (i) the shelf stocking, (j) the pricing (putting a price physically on the item), and (k) the ordertaking. Many of these steps are eliminated in a store door delivery system. In addition, the analysis found the average distance between bottler location and store was less than the average distance between chain warehouse and store.

The analysis also took into account average distances between bottling plant and warehouses, and bottling plants and stores; the average cost per mile of operating different types of vehicles; the quantity of product (whether cans or bottles and if bottles, what size and weight) that could be hauled on different types of vehicles; labor costs, as well as the time required to perform each function.

The analysis produced these results: (1) for 24 12-oz. cans, the cost of distribution through the warehouse system was just barely less than the cost of distribution through the store door delivery system; (2) for bottles, the cost of distribution through the warehouse system was higher than through the store door delivery system; and (3) for returnables, the warehouse distribution system would not be able to efficiently handle returnables.

In our opinion, these conclusions are equally valid today.

Indeed, the Commission itself concluded that returnables could not efficiently move through warehouses, that the store door delivery system was slightly more cost-efficient than warehouse delivery for large, one-way bottles, and that warehousing has a cost advantage of less than one cent per case for sales of cans only to chain stores (Majority Opinion at p. 25, n.25; 58-60).

In sum, we believe that the store door delivery system is a more cost-efficient system than the warehouse system.

In addition to the issue of which distribution system is more cost efficient, the issue of which distribution system is more competitively efficient was also raised at the trial of the FTC case. (See Joint Brief at pp. 40-46, 75-79; Reply Brief at pp. 23-24). There, the undisputed evidence was that soft drinks, where distributed through the warehouse system, are not marketed in and never reach the non-chain accounts. (It is critical to note that the non-chain accounts constitute 90% of the total number of accounts served by the typical Coca-Cola

bottler and over 75% of that typical bottler's sales volume.)
Second, warehouse distributed soft drinks are not marketed in the low priced returnable container. Third, the warehousing of soft drinks leads to serious quality control problems (Joint Brief at pp. 54-56) and out-of-stock problems. In short, the warehouse distribution system is less competitively efficient than the store door delivery system. Warehousing is "efficient" only if a supplier wants to compete for a limited number of customers, in a limited number of packages, with limited quality control and limited merchandising, service and point of sale advertising. (Joint Brief at pp. 47-49 and nn. 63-64, 76-77 and n. 108). Bottlers of Coca-Cola and other brands using exclusive territorial restraints are the strongest overall competitors in the soft drink market in every area because they use store door delivery rather than warehouse delivery for their products.

24. No, see answer to Question 7. This legislation should apply to all soft drink products, uncarbonated as well as carbonated. A distinction between carbonated and uncarbonated soft drinks is artificial and does not reflect marketplace realities. As I have already stated, the Commission found Coca-Cola to be closely price sensitive to non-carbonated soft drinks (Majority Opinion at pp. 51-52). Non-carbonated products, such as canned iced teas, have become effective national competitors by the use of exclusive territories in trademark licenses and entering markets through piggybacking on established bottlers of carbonated soft drink brands. (Joint Brief at pp. 70-74).

25. H.R. 3567 does not authorize any enforcement measures which violate the Antitrust laws. The enforcement language merely makes clear that it is not unlawful to enforce a territorial provision in a bottler contract so long as there is substantial and effective competition with other products of the same general class.

The enforcement language in H.R. 3567 derives from the tendency among lower courts, subsequent to the Supreme Court decision in United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967) before it was overruled by GTE-Sylvania, to draw a peculiar distinction in determining the legality of vertical restraints between those which were enforced in a "firm and resolute" manner and those that were not so enforced. The history of such judicial construction, done by courts to evade the unreasonable results of the Schwinn decision, is outlined in the American Bar Association's 1977 monograph entitled "Vertical Restrictions Limiting Intrabrand Competition" (pp. 14-15, nn. 37-39). The enforcement language in H.R. 3567 is necessary to avoid any misplaced reliance upon this earlier line of cases.

26. The questions do not apply to Coca-Cola bottlers. Each bottler has made a substantial investment in plant, equipment, warehousing, vehicles, bottles, and coolers.

. . . . .

It also should be noted that the rationale for this legislation is not restricted to the protection of capital investment. The arguments in support of the bill include:

a) Enhancement of vigorous interbrand competition resulting in lower consumer prices.
b) Preservation of the low cost returnable package.
c) Widespread product availability for the consumer.
d) Preservation of a distribution system that has made market entry easy for new products which can "piggyback" on the existing bottler system.
e) Continuation of a decentralized and less concentrated bottler network owned by local businessmen.
f) Preservation of high quality control standards.

27. No, the Bill does not place limitations on customers of the bottlers. It does, however, permit the inclusion and enforcement of a provision in a bottler contract which limits the bottler to selling to customers "only for ultimate resale to consumers within a defined geographic area...".

The inclusion of such a provision in the bill is necessary in order to retain the system of route delivery that has resulted in such a high degree of interbrand competition. This system would be destroyed by sales to central food chain warehouses or other customers that would transship products into territories of numerous bottlers -- a process which would ultimately lead to greater industry concentration, fewer brands, fewer packages, less availability, less service, lower quality and higher prices. (See Joint Brief at pp. 79-85).

The Coca-Cola Company and its bottlers have never engaged in any "boycotts" and the bill would not authorize "self enforcement by inducing boycotts...". The Coca-Cola Company has never found it necessary to resort to court proceedings against any bottler to enforce the territorial restrictions in any of its trademark license agreements with any bottler.

In the past when transshipment has occurred, the Company has discussed with individual bottlers their obligations under their trademark license agreements. These situations have been rectified by actions taken by individual bottlers to assure their compliance with such obligations.

28. No. The territorial franchise system has had the opposite effect. It has fostered vigorous interbrand competition and use of the returnable container, both of which have led to low prices for the consumer.

There is dramatic evidence that consumers have had the benefit of low prices. Eighty years ago the 6½ oz. returnable bottle of Coca-Cola sold for 5¢, just under 1¢ per ounce. Today the 32 oz. returnable bottle sells for just under 1¢ per ounce. The average for all returnable packages of Coca-Cola is 1.2¢ per ounce--and the returnable package represents 60% of Coca-Cola purchased for home consumption. There could hardly be better evidence of the competitive nature of the present system.

The Coca-Cola Company would oppose an amendment of the type proposed because:

a) It would offer exemptions from the Antitrust laws. We are neither seeking nor do we think that an outright exemption from the Antitrust laws is desirable.

b) Instead of a standard of legality based on an analysis of competitive factors in a given geographic area, including actual price levels, the proposed amendment would substitute an abstract non-existent measurement of legality, i.e., what prices in some undefined period in some undefined market would have been in the absence of territories. Such an abstract test would be impossible to apply in the real world and would only lead to continuous litigation.

c) If we understand it correctly, the proposed amendment would exempt some, not all, bottlers from the reach of the Antitrust laws. A selective exemption process of the type proposed would be anti-competitive and impractical in that some bottlers would be free to engage in practices prohibited to others.

The wisdom of the bill as written is that it applies immediately to the soft drink industry the teaching of GTE-Sylvania that (a) low prices normally result from the existence of vigorous interbrand competition and that (b) interbrand competition is usually increased by the use of vertical intrabrand restraints.

There is already substantial judicial precedent to guide the courts in applying H.R. 3567 as drafted. Any attempt to legislate an artificial guideline of that type suggested would cause endless interpretation problems for the Courts and probably lead to results unintended by the proponents of this legislation in the Congress and elsewhere.

29. Over the years changing market conditions such as shifts in population, changes in transportation and improved technology have led to realignment of territorial lines. These adjustments have been accomplished by merger or the consolidation of territories.

Thus, under the current system, territorial boundaries change in response to natural market forces. Further, the current system allows a bottler who sells his assets to recapture at a fair price the fruits of the life work of himself and often of prior generations of his family.

Notwithstanding these realignments, the fundamental importance of territories should not be overlooked. Territories are just as important to the soft drink industry today as they were 80 years ago. They have fostered vigorous interbrand competition which has led to wide availability and low consumer prices. They have encouraged a decentralized bottling system owned by businessmen close to their communities and, through "piggy-backing", have made it easy for new products to achieve market entry and national distribution.

ANSWERS TO QUESTIONS SUBMITTED TO ERNEST GELLHORN, UNIVERSITY OF VIRGINIA BY CHAIRMAN PETER W. RODINO, JR., BY LETTER ON MAY 8, 1980

1. [a] What would be your opinion of an amendment that would amend Section 2 of H. R. 3567 to strike "with other products of the same general class" and insert "between trademarked soft drink products." [b] Or, alternatively, replace the same phrase with "in any relevant market." [c] Doesn't the use of the word "any" suggest that, in the case of more than one relevant market (e.g., a relevant overall market and a relevant sub-market), the proviso would be satisfied even if substantial and effective competition exists in only one of the two relevant markets?

a. The substitution of the language "between trademarked soft drink products" in the proviso would not be an improvement of Section 2 of H. R. 3567. My concern is that it would freeze in legislative language a confining and possible incorrect definition of the economic market in which a bottler competes, namely, trademarked soft drink products being sold in the same territory. Markets are dynamic and changing and the law should likewise be responsive and flexible. It therefore should be drafted to allow for future developments. Thus, while I would not oppose this definition, it does not seem to be an improvement over the current draft. In addition, it may also be unduly narrow in limiting the area of competition to trademarked products; as the idea of generic marketing in food and drink products expands, it seems likely that non-trademarked products may compete effectively with trademarked soft drinks. Finally, rules of grammar require that the word "among" be substituted for "between."

b. Substitution of the phrase "in any relevant market" would, in my opinion, be an important improvement in H. R. 3567. This is the economic test for product (and geographic) market definition that has been used in antitrust cases for generations. It has a well developed meaning and has been applied in a sensitive and sophisticated fashion in recent years. It is also my understanding

that Professor Jonathan Rose agrees with this assessment of the proposed substitution. It is, moreover, consistent with the Supreme Court's ruling in Continental TV, Inc. v. GTE Sylvania, Inc., in that the Court's entire discussion of competitive effect there depended on a definition of the locus of competition. (In that case the Court viewed competition among all television sets as the product market. 97 S. Ct. 2549, at 2559 n.19.) This language, moreover, is more felicitous than the Clayton Act's awkward terminology: "any line of commerce in any section of the country".

c. The term "any" in the definition examined in paragraph b above does permit the interpretation suggested in the question, namely that competition in any relevant market would immunize exclusive territorial or customer provisions in other markets, although I believe that to be a strained interpretation. This problem, if it be viewed as such, could be corrected by clear legislative history as contained in the Senate Report on identical legislation. See S. Report No. 96-645, Senate Committee on the Judiciary, 96th Cong., 2d Sess. 9-10 (1980). Another approach accomplishing the same objective would be to modify the language slightly and make it read "with soft drinks or other products within the relevant market." The proviso would then read "Provided that such product is in substantial and effective competition with soft drinks or other products within the relevant market." The result would be to protect nonprice vertical restrictions applied to trademarked soft drink products only where they face substantial and effective competition. The important point--that I would also urge be made clear in the accompanying report--is that this statutory limitation of antitrust liability would apply only where competition among brands protects the consumer interest.

2. [a] Why should the benefits of this legislation be available to a licensee who has no capital investment in a bottling operation? [b] Would you endorse an amendment limiting the bill to actual bottlers since the protection of the capital investment is a key rationale of this legislation?

a. This legislation is designed to allow bottlers and producers of soft drink products to compete in services, promotions and other ways for customers. Thus it is not limited to protecting capital investment, although that is of course one of its proper aims and effects. Since the purpose of the bill is to permit competitive rivalry in whatever form it is present--all for the benefit of consumers--the existence of capital investment in a bottling operation is irrelevant to the design of this bill.

b. As explained above, I would not endorse an amendment limiting the bill to "actual bottlers." It misunderstands the aim and operative effect of this legislation. Moreover, it is not desirable to add such a limiting amendment to the bill which could confuse its interpretation and might mislead courts and agencies in their application of it.

3. After the discussion of Section 3 of H. R. 3567, at our last hearing, a representative of one group of bottlers indicated that they were willing to delete Section 3. In light of your testimony that the purpose of H. R. 3567 is to codify the Supreme Court's decision in Sylvania, would you oppose the compromise proposal of these bottlers?

In my testimony, I indicated that the overall purpose of H. R. 3567 was to codify the Supreme Court's decision in Sylvania. However, in response to questioning on Section 3, I also noted that its provisions were a response to the uncertainty first of Supreme Court and more recently of Federal Trade Commission decisions on nonprice vertical restraints. The result was that the FTC complaint against several bottlers had tolled the statute of limitations and created an undue exposure of these bottlers to treble damage liability. Therefore the compromise proposal, which apparently only would delete Section 3 and add nothing in its place, seems not to be a response. Thus I could not endorse this proposal.

4. Professor Rose suggests that one could interpret the language "nothing contained in any antitrust laws shall render unlawful the inclusion and enforcement" of any provision granting an exclusive geographic territory, to make horizontal activity lawful. In your testimony before the Senate Antitrust and Monopoly Subcommittee, you stated that this legislation "should not be able to be used as a cover for horizontal market divisions, for customer boycotts or wholesaler boycotts." Would you oppose an amendment to this bill making it absolutely clear that it does not authorize the use of any horizontal restraints?

I would not oppose an amendment to this bill making it clear that it does not authorize the use of horizontal restraints. On the other hand, I would question whether this addition is necessary. There is nothing in the bill suggesting that horizontal restrictions would be protected or affected. Much simpler is the approach taken by the Senate Report, supra at 10, that "nothing in this bill protects agreements among bottlers or among syrup companies as to prices to be charged for trademarked soft drink products, or as to joint refusals to deal with any person or entity, or as to the allocation of territories."

APPENDIX 4

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

BUREAU OF COMPETITION

September 24, 1979

Honorable Peter W. Rodino, Jr., Chairman
Committee on the Judiciary
House of Representatives
Washington, D.C. 20515

Dear Chairman Rodino:

Your letter of August 3, 1979 requested my views on H.R. 3567, a bill which would create a special standard for determining the legality under the antitrust laws of exclusive territorial restrictions in the soft drink industry. Similar legislation, intended to create a limited antitrust exemption for the benefit of soft drink bottlers, has been introduced without success in prior sessions. I have opposed such legislation in the past and I continue to oppose it in its present form.

First, I believe that exemptions from the antitrust laws cannot be justified, except in rare instances. I agree with the National Commission for the Review of Antitrust Laws and Procedures that proponents of antitrust immunity legislation must clearly demonstrate that anticompetive effects would result from the application of the antitrust laws in the absence of the proposed legislation.[1] No such demonstration has been made with respect to H.R. 3567. Passage of this legislation merely opens the door to consideration of similar legislation creating special interest exemptions in the range of industries subject to antitrust law enforcement.

Second, on April 7, 1978 the Federal Trade Commission issued its decisions in the Coca-Cola Company, Docket No. 8855 and Pepsico, Inc., Docket No. 8856. These decisions constitute rulings in adversary litigation matters. Respondents in each of these cases have taken appeals, both of which are now pending in a consolidated proceeding before the U.S. Court of Appeals for the District of Columbia Circuit. These Commission decisions, which are not final until reviewed and sustained on appeal, hold that franchise agreements under which a soft drink licensor grants to a bottler-licensee an exclusive sales territory in which to sell soft drinks packaged in cans and non-refillable bottles are anticompetitive and violate Section 5 of the Federal Trade Commission Act. The Commission also held that the same restrictions, as applied to soft drinks in returnable bottles, are reasonable and that they do not violate the law.

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1. Report of the National Commission for the Review of Antitrust Laws and Procedures 186-187 (1979).

It is important to bear in mind that these decisions, now under appellate review, were reached only after full trials on the merits in which respondents and local bottler-intervenors fully defended the challenged agreements and offered a wide range of evidence intended to show the reasonableness of the agreements and other factors in justification of territorial exclusivity. Many of the same arguments currently being made by the industry proponents of H.R. 3567 were made by respondents during the proceedings before the Commission. All of this evidence was carefully considered by the Commission in reaching its decisions.

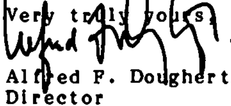
Since the Commission's decisions are presently before the Court of Appeals for review, detailed extra-judicial comment and argument by the Commission's staff as to specific aspects of the cases would not be appropriate. We believe, however, that the Commission's decisions were fully supported by the trial records and are in the public interest.

H.R. 3567 would overrule the Commission's Coke and Pepsi decisions by giving the soft drink industry what would amount to a special exemption from the antitrust laws. In the past we have vigorously opposed such legislation because it is in direct conflict with the interests of consumers. I see no reason why the soft drink industry cannot and should not be subject to the same competitive ground rules that apply to other businesses.

A copy of the Commission's decision in the Coca-Cola case is attached.

I trust that this information is of assistance to you.

Very truly yours,



Alfred F. Dougherty, Jr.
Director

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:

Michael Pertschuk, Chairman
Paul Rand Dixon
Elizabeth Hanford Dole
David A. Clanton

In the Matter of THE COCA-COLA COMPANY, a corporation; COCA-COLA BOTTLING CO. (THOMAS), INC., a corporation; COCA-COLA BOTTLING WORKS (THOMAS), INC., a corporation; and COCA-COLA BOTTLING WORKS 3RD, INC., a corporation.	DOCKET NO. 8855

FINAL ORDER

This matter having been heard by the Commission upon the appeal of complaint counsel from the initial decision, and upon briefs and oral argument in support thereof and in opposition thereto, and the Commission, for reasons stated in the accompanying opinion, having granted the appeal:

IT IS ORDERED, that the initial decision and order of the administrative law judge be, and they hereby are, vacated, and the findings of fact and conclusions of law contained in the accompanying opinion of the Commission be, and they hereby are, adopted as the findings and conclusions of the Commission in this matter.

Accordingly, the following cease and desist order is hereby entered:

ORDER

I.

IT IS ORDERED, that the following definitions shall apply in this order:

A. Allied products - the soft drink products of The Coca-Cola Company, other than "Coca-Cola," including Sprite, Fresca, Fanta, Tab and Mr. PiBB, among others;

B. Bottler - any individual, partnership, corporation, association, or other business or legal entity which purchases respondents' syrups or concentrates for use in the manufacture and sale, primarily at wholesale, of finished soft drink beverages;

C. Central warehousing - a method of distribution in which soft drink products are received at a storage facility and either resold or delivered to retail outlets or wholesalers;

D. Concentrate - the basic soft drink ingredients, either dry or liquid, to which sugar is added to prepare a syrup;

E. Confidential commercial information - facts, data, statistics, or other material which concern the business of licensed Coca-Cola or allied product bottlers including, but not limited to, trade secrets, customer lists, plant equipment or production capacities, or syrup and concentrate purchases obtained by or available to, respondents pursuant to, or as a result of, any agreement, understanding, or provision of a trademark license, and which could, if disclosed to a competitor, cause substantial harm to the competitive position of the bottler from whom the material was obtained;

F. Nonrefillable - a special container designed to be filled only once with finished Coca-Cola or allied soft drink beverages;

G. Post-mix syrup - a soft drink ingredient which is used in fountain-dispensing or vending equipment and which is usually sold by bottlers and other wholesalers in steel tanks. A typical post-mix system draws one ounce of syrup from a tank, usually having about a five-gallon capacity, and mixes it at the point of sale with five ounces of carbonated water to produce finished soft drink beverages;

H. Pre-mix system - a system which draws from a tank, usually having about a five-gallon capacity, a finished serving of a soft drink product containing both syrup and carbonated water, "pre-mixed," to produce finished soft drink beverages;

I. Soft drink products - nonalcoholic beverages and colas, carbonated and uncarbonated, flavored and nonflavored, sold in bottles or cans, or through pre-mix or post-mix systems or the like;

J. Syrup - a mixture of ingredients in liquid form which, when mixed with carbonated water, becomes a finished soft drink product.

II.

IT IS FURTHER ORDERED, that The Coca-Cola Company; Coca-Cola Bottling Co. (Thomas), Inc.; Coca-Cola Bottling Works (Thomas), Inc.; and Coca-Cola Bottling Works 3rd, Inc., and the officers, agents, representatives, employees, successors, and assigns of each respondent, directly or through any corporate or other device, in connection with the advertising, merchandising, offering for sale, and sale or distribution of soft drink products, including syrups and concentrates, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from directly or indirectly:

A. Attempting to enter into, entering into, continuing, maintaining, enforcing, or renewing any contract provision, combination, understanding, or agreement to limit, allocate, or restrict the territory in which, or the persons or class of persons to whom, licensed Coca-Cola or allied product bottlers may sell or distribute post-mix syrup or finished soft drink beverages packaged in pre-mix containers or in nonrefillable bottles or cans.

B. Imposing or attempting to impose any limitations or restrictions respecting the territories in which, or the persons or class of persons to whom, bottlers may sell or distribute post-mix syrup or finished soft drink beverages packaged in pre-mix containers or in nonrefillable bottles or cans.

C. Refusing to sell, threatening to refuse to sell, or impairing sales to any bottlers, operating pursuant to a license consented to, granted by, approved by, or ratified by The Coca-Cola Company; Coca-Cola Bottling Co., Inc.; Coca-Cola Bottling Works, Inc.; or Coca-Cola Bottling Works 3rd, Inc., for the duration of the license, anything used in the manufacture and sale of soft drink products, including, but not limited to, syrups and concentrates or the container in which they are sold, or otherwise in any way penalizing any such bottler because of the territory in which, or the persons or class of persons to whom, the bottler sells or distributes post-mix syrup or finished soft drink beverages packaged in pre-mix containers or nonrefillable bottles or cans.

D. Refusing to deliver all of a licensed Coca-Cola or allied product bottler's order for syrups, flavoring, or concentrates because the bottler has made, or intends to make, sales of post-mix syrup or soft drinks packaged in pre-mix containers or nonrefillable bottles or cans to customers outside of the territory granted to the bottler, or because the bottler has made, or intends to make, such sales to customers within the territory granted to the bottler, with knowledge that the customer has transshipped or will transship such soft drinks outside of the territory.

E. Impeding, hindering, or preventing, either directly or indirectly, the methods, including, but not limited to, central warehouse delivery, by which licensed bottlers may distribute Coca-Cola or allied products, Provided, however, that respondents may (1) establish quality standards, including standards for the rotation of Coca-Cola and allied products inventories in the central warehouse and at retail delivery locations, irrespective of whether the soft drinks are redelivered from a warehouse or delivered directly to the retail outlet by a bottler; (2) require the bottlers to use a uniform container dating system so that bottlers and retailers will recognize the date without reference to a code; (3) require the bottlers to be responsible, directly or indirectly, for the maintenance of such standards of quality; and (4) require each bottler to place an identification mark of origin on each bottle, bottle cap, or can for the purpose of monitoring compliance with such quality control standards.

F. Enforcing or aiding in the enforcement of any contract provision, agreement, or understanding providing for entry into or examination of the plant and facilities of any independent bottler by another independent bottler.

III.

IT IS FURTHER ORDERED, that respondents shall provide for the protection of confidential commercial information acquired from bottler licensees of Coca-Cola or allied product brands as follows:

A. Access to or use of confidential commercial information obtained by respondents, their officers, employees, or agents concerning the production, packaging, distribution, promotion, or sale of Coca-Cola or allied product brands by any licensed bottler shall be restricted to those of respondents' officers, employees, or agents who are neither involved in nor responsible for the production, marketing, promotion, or sale of finished soft drink products by respondents' bottling or canning operations, divisions, subsidiaries, or affiliates.

B. Such officers, employees, or agents who receive, process, or evaluate package-approval requests; process or fill syrup or concentrate purchase orders; conduct on-site inspections of independent bottling plants and facilities; or receive or review confidential commercial information obtained from any independent Coca-Cola or allied product bottler in the course of carrying out the provisions of any soft drink trademark licensing agreement, shall refrain from making any such confidential information available to, or communicating or discussing any such information with, any person involved in or responsible for the production, marketing, promotion, or sale of finished soft drinks by respondents' bottling or canning operations, divisions, subsidiaries, or affiliates.

C. Such officers, employees, or agents who receive, process, or have access to confidential information concerning the business of individual independent Coca-Cola or allied product bottler licensees, shall refrain from suggesting, influencing, or making recommendations to any person concerning the production, distribution, marketing, promotion, or sale of finished soft drinks by respondents' bottling or canning operations, divisions, subsidiaries, or affiliates, _Provided, however_, that this provision shall not apply to respondents' officers, employees, or agents who receive, review, or evaluate data, information, or statistics only in aggregate form or quality control inspection reports which include such information as bacteriological tests, water analyses, water carbonation and syrup content tests, sanitation inspection checks, or bottle washing solution analyses, so long as such reports do not also contain information concerning the bottler's plant equipment, production capacity, or similar types of confidential commercial information.

D. Respondents shall provide each officer, employee, or agent who receives, reviews, or has access to confidential information as set forth in subparagraphs A. through C. above with a copy of this order and an explanation, in writing, of the restrictions this order imposes on access to and the use of such information.

E. Subparagraphs A. through C. above shall not apply (1) to data or information which is in the public domain or which has entered the public domain from a source other than respondents or their officers, employees, or agents; or (2) to transactions involving orders from licensed Coca-Cola or allied product bottlers for finished canned or bottled soft drink products prepared by any respondent for a bottler pursuant to an agency canning or bottling agreement.

IV.

IT IS FURTHER ORDERED, that within sixty (60) days from the date The Coca-Cola Company receives service of this Order, it shall service a copy of this Order upon all bottlers of its soft drink products.

V.

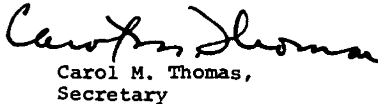
IT IS FURTHER ORDERED, that respondents The Coca-Cola Company; Coca-Cola Bottling Co. (Thomas), Inc.; Coca-Cola Bottling Works (Thomas), Inc.; and Coca-Cola Bottling Works 3rd, Inc., shall forthwith distribute a copy of this order to each of their subsidiaries and operating divisions.

VI.

IT IS FURTHER ORDERED, that respondents The Coca-Cola Company; Coca-Cola Bottling Co. (Thomas), Inc.; Coca-Cola Bottling Works (Thomas), Inc.; and Coca-Cola Bottling Works 3rd, Inc., shall notify the Federal Trade Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change which may affect compliance obligations arising out of the order.

IT IS FURTHER ORDERED that each respondent shall, within sixty (60) days after service upon it of this order, file with the Commission a report in writing setting forth in detail the manner and form in which it has complied with this order.

By the Commission. Chairman Pertschuk did not participate in the consideration of this matter. Commissioner Clanton dissents.



S E A L

Carol M. Thomas,
Secretary

ISSUED: April 7, 1978

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:

Michael Pertschuk, Chairman
Paul Rand Dixon
Elizabeth Hanford Dole
David A. Clanton

In the Matter of THE COCA-COLA COMPANY, a corporation; COCA-COLA BOTTLING CO. (THOMAS), INC., a corporation; and COCA-COLA BOTTLING WORKS (THOMAS), INC., a corporation; and COCA-COLA BOTTLING WORKS 3RD, INC., a corporation.	DOCKET NO. 8855 OPINION

By Dole, Commissioner:

The basic question on this appeal is whether territorial restrictions which eliminate competition among the independent bottlers of Coca-Cola and allied soft drink products are unfair within the meaning of Section 5 of the Federal Trade Commission Act.

I. Introduction

Respondent Coca-Cola requires little introduction. It is a diversified corporation with interests ranging from steam boilers to orange juice. In 1968 it had consolidated net sales in excess of $1.1 billion and consolidated assets exceeding $802 million. Pertinent to the issues raised in the complaint in this proceeding are the operations of its Coca-Cola USA division. It is this division which manufactures and sells the soft drink syrups and concentrates used in the

processing of finished flavored carbonated soft drinks sold under one or more of the trade names licensed by respondents to the bottlers. 1/ In 1968 its syrup sales to bottlers exceeded $246 million.

Around the turn of this century, The Coca-Cola Company sold its right to bottle Coca-Cola and licensed the "Coca-Cola" trademark, in perpetuity, to private investors who, as independent businessmen, operated their own bottling facilities within assigned territories. 2/ At the time, The Coca-Cola Company itself produced no bottled soft drinks, and although it does today in certain areas of the country, its entry into the business of bottling the products which bear its trademarks results from the reacquisition of the bottling rights which had been previously granted to local bottlers. Today it operates 27 bottling plants which serve exclusive territories 3/

1/ In addition to Coca-Cola syrup, The Coca-Cola Company manufactures the key syrup and concentrate ingredients for several other soft drink products. These products, including Sprite, Fresca, Fanta, TAB, and Mr. PiBB, are collectively referred to as "allied products." The first of these, Sprite and Fanta, were introduced in the early 1960s. (Tr. 518-19, 692).

2/ The Thomas Company respondents are the successors in interest of J. B. Thomas, one of the original purchasers of Coca-Cola bottling rights, whose exclusive territory covered states in the South, Southeast, and northward along the eastern seaboard to New York. Respondent Thomas Company granted exclusive bottling licenses to numerous independent bottlers in Alabama, Delaware, Indiana, Maryland, Mississippi, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Virginia, and West Virginia. The Thomas Works respondent licensed bottlers in Alabama, Georgia, Kentucky, and Tennessee. Respondent Works 3rd, Inc., granted exclusive bottling licenses to bottlers located principally in Pennsylvania and New Jersey.

3/ A subsidiary of The Coca-Cola Company, Canners for Coca-Cola Bottlers, Inc., as its name implies, operates canning plants which produce canned soft drinks for the bottlers. In 1974, 42 percent of the canned product of this subsidiary was produced for the bottling subsidiaries of respondent Coca-Cola, 38 percent was produced for the independent bottlers, and 20 percent was produced for sales overseas. (Tr. 846).

encompassing about 14 percent of the population of the U.S. (RPF 44; Tr. 828, 844). 4/ The rest of respondents' bottlers are relatively independent businessmen who conduct their commercial affairs as they see fit, subject to three key limitations:

First, when The Coca-Cola Company decided to sell the rights to bottle its product, it agreed to sell to its bottlers a continuous supply of the necessary soft drink syrups, but it refused to yield the secret Coca-Cola syrup formula which would have enabled the bottlers to produce the syrup themselves. Later, when the allied products were introduced, it adopted a similar policy. As a result, respondent The Coca-Cola Company is the bottlers' only source of vital Coca-Cola and allied product syrups or concentrates used in the preparation of the finished soft drinks. 5/

Second, respondent Coca-Cola has retained the right to establish quality standards for the products which carry its trademarks and to insist that the bottlers maintain those standards. Failure on the part of a bottler to meet the quality standards it has established may trigger one of the few contingencies justifying the forfeiture of a bottler's bottling rights. (Tr. 778).

4/ The following abbreviations are used for citations:

ID - Initial Decision of the Administrative Law Judge;
IDF - Initial Decision Finding;
Tr. - Transcript of Testimony;
CX - Commission Exhibit;
RX - Respondents' Exhibit;
App. Br. - Complaint Counsel's Appeal Brief;
Ans. Br. - Respondents' Answering Brief;
Rep. Br. - Complaint Counsel's Reply Briefs;
CPF - Complaint Counsel's Proposed Findings of Fact;
RPF - Respondents' Proposed Findings of Fact;
IPF - Intervenors' Proposed Findings of Fact.
Unless otherwise indicated, "respondent" in the singular refers to The Coca-Cola Company.

5/ The bottler purchases these ingredients from respondent Coca-Cola, and if he was originally licensed to bottle Coca-Cola by one of the Thomas Company respondents, the Thomas Company receives a copy of the purchase order and a commission on the sale. (Tr. 631, 817-18, 855).

Third, respondents have imposed, by contract, and have enforced, in practice, the territorial restrictions which prevent these independent soft drink bottlers from competing with one another in the sale of bottled, canned, and pre-mixed Coca-Cola and the allied soft drink products made from the syrups and concentrate ingredients produced by The Coca-Cola Company. 6/ It is this latter interference with the bottlers' geographic markets which resulted in the complaint now before us. In essence, this complaint alleges that these territorial

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6/ Respondents make no attempt to understate their firmness in enforcing these restrictions. (Tr. 669). As a consequence, border disputes involving sales of bottled and canned Coca-Cola and allied products by one bottler into the territory of another are rare and usually insignificant. (RPF 47-54, IDF 63-65). According to the testimony of Mr. J. Lucian Smith, President of The Coca-Cola Company, respondents have a system to detect unusually large syrup orders by a bottler which may indicate extra-territorial sales. Moreover, respondents candidly submit that:

> If an instance of transshipment is brought to the attention of The Coca-Cola Company, it will attempt to contact the bottler from whose territory the product was alleged to have come, and almost always "the bottler does what he can to stop the practice." (RPF 54).

Should a bottler refuse to heed such a warning, his supply of syrup or concentrates may be rationed. Thus:

> ... in Taft, California, when it was clear that a bottler was purchasing extra quantities of Coca-Cola syrup for the purpose of selling Coca-Cola in cans outside his territory. (sic) The Coca-Cola Company sold the bottler only enough syrup to meet existing demands and likely growth in demand within his territory. (RPF 54).

Respondents have, for the better part of this century, successfully confined their bottlers geographically and prevented intrabrand competition among the bottlers in the sale of Coca-Cola and allied products in bottles and cans.

restrictions injure competition among the bottlers and deprive retailers and consumers of the benefits of open competition in the sale of Coca-Cola and the allied products packaged in bottles and cans. 7/

After a lengthy trial which delved in detail into the day-to-day business of bottling soft drinks, the administrative law judge issued his initial decision in which he concluded that territorial restrictions are, in the context of the soft drink industry, procompetitive. Accordingly, he entered an order dismissing the complaint, and counsel supporting the complaint have appealed.

In addition to complaint counsel and the named co-respondents, there are 14 independent Coke bottlers and the Coca-Cola Bottlers Association taking part in these proceedings. In 1971 this association included 99 percent of the domestic bottlers of Coca-Cola. At various times during the pretrial, these bottlers and their association were granted leave to intervene with rights of full participation before the administrative law judge. The intervenors filed briefs on appeal and were afforded time to present oral argument before the Commission. Also participating at the oral argument and on brief were Consumers Union, Consumer Federation of America, and National Consumer Congress. The consumer organizations were, by order entered March 2, 1976, granted leave to appear, amici curiae, and the respondents and intervenors were authorized to file additional briefs in response to amici.

We have carefully reviewed the arguments advanced in briefs and at oral argument in light of the record and the initial decision and have concluded, for the reasons stated below, that the territorial restraints respondents impose on their independent bottlers are unreasonable and in violation of Section 5 of the Federal Trade Commission Act. Our order will lift the restrictions which place limitations on the sale of Coca-Cola and allied products packaged in pre-mix containers, or in nonrefillable, nonreusable bottles and cans. For reasons discussed in detail later in this opinion, we find it unnecessary to disturb the exclusive territorial relationships with respect to the sale of these products packaged in returnable, refillable bottles. The Commission has also given careful consideration

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7/ Each respondent is engaged in commerce as "commerce" is defined in Section 5 of the Federal Trade Commission Act, and the acts and practices challenged in this proceeding occur in the course of such commerce. (CPF 668-681; CX 59-72; Tr. 812-17, 664-65; RPF 50-54).

to the arguments of respondents and the bottler intervenors advocating geographic market segmentation as a legitimate method of protecting "small" bottlers from intrabrand competition. We have reviewed, in-depth, the evidence and the precedents cited in support of this contention, and have concluded that this argument is without merit. Accordingly, we hereby vacate the judge's order dismissing the complaint and his findings of fact and conclusions 8/ and substitute in their place the findings and conclusions noted in this opinion.

II. Scope of Review

A. Classifying the Restraints

In their briefs on appeal, both amici and complaint counsel contend that these restrictions are unlawful; complaint counsel believe that the trial record as a whole will, upon *de novo* review by the Commission, demonstrate that the challenged practice constitutes an unreasonable vertical restraint of trade. They also take an alternative position: that the restraints are per se illegal horizontal market division agreements. (App. Br. p. 10). The consumer organizations, appearing amici curiae, urge that the practices be declared per se illegal horizontal and vertical restraints on the distribution of Coca-Cola and the allied products under the Supreme Court's decisions in *Schwinn* 9/ and *Topco*. 10/ While the appeal in this matter was pending, however, the Supreme Court in

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8/ A comparison of respondents' proposed findings and briefs with the initial decision shows that respondents and the judge were of like mind to an extraordinary degree on all key disputed issues. We have carefully considered each of these findings in light of our own de novo review of the entire record and have determined that the judge erred in the legal and factual conclusions which he drew from the evidence. For example, *compare* IDF 183-187 *with* RPF 326-329; IDF 188, 189 *with* RPF 333; IDF 190, 191 *with* RPF 336; IDF 192 *with* RPF 337; IDF 193 *with* RPF 339; IDF 194, 195 *with* RPF 341. (*But see* Text at 65-77 *infra*).

9/ U.S. v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

10/ U.S. v. Topco Associates, Inc., 405 U.S. 596 (1972).

Continental T.V., Inc. v. GTE Sylvania, Inc., ___ U.S. ___, 1977-1 Trade Cases, ¶61,488 (1977), overruled the vertical per se rule stated in Schwinn, but it did not rule out the application of a per se standard in appropriate vertical restraint cases. The court noted that in overruling Schwinn:

> ... we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under Northern Pac. R. Co. But we do make it clear that departure from the rule of reason standard must be based upon demonstrable economic effect rather than - as in Schwinn - upon formalistic line drawing. (Id. at 71,902).

In the aftermath of GTE, Topco-type market division agreements among competitors clearly remain per se illegal (GTE, supra at 71,901 fn. 28), while supplier-imposed vertical territorial restrictions must generally be policed under the rule of reason unless it can be demonstrated that, in a particular situation, they typically have or are likely to have a "pernicious effect on competition" and that they "lack ... any redeeming virtue...." (Id. at 71,902). Under the court's most recent pronouncement, then, the first step in evaluating these restraints is to classify them as horizontal or vertical.

1. The Topco Theories

The Coca-Cola Company has over the years, by acquisition, integrated forward into the bottling business. Thus complaint counsel assert that the territorial restraints on the distribution of the Coca-Cola brand soft drink were vertical when respondent was simply a supplier of soft drink ingredients, but now that it has acquired bottling facilities, the restraints are horizontal. In addition, when the Coca-Cola Company, while operating its bottling subsidiaries, introduced its allied product lines under licensing agreements which granted exclusive territories to its independent bottlers as well as its own bottling facilities, it allegedly became involved in a "horizontal" market division scheme for the sale of the allied products. (App. Br. 55-56, Amici Br. 13). Amici and complaint counsel contend that geographic market restraints imposed under these circumstances serve no purpose except to stifle competition. Both situations are said to constitute per se illegal horizontal market divisions under the Supreme Court's decision in Topco.

a. Acquisition of Bottling Subsidiaries by The Coca-Cola Company

Although The Coca-Cola Company is both a supplier of syrup and a soft drink bottler, the record as a whole demonstrates that the restraints involved here are not primarily "horizontal" within the meaning of the court's Topco decision. Admittedly, the line which separates the "vertical" from the "horizontal" forms of a geographic market allocation arrangement is not always as easy to distinguish as the market plane to which they refer might tend to indicate. Both types of restraints at times may, at a given level of production or distribution, exhibit similar competitive characteristics which, on the surface, obscure the firm or firms which are their true source. (U.S. v. Sealy, Inc., 388 U.S. 350, 352 (1967)). Consequently, only by ignoring the essential relationships which exist between the respondents and the independent bottlers might it be concluded that the restraints are Topco-type "horizontal" market allocations based solely on the fact that respondents operate bottling facilities and are thus potential competitors of the independents, and vice versa. 11/

11/ Dual-distributing manufacturers and their independent wholesalers obviously can be "in competition with each other" and have so been adjudged in cases which have, for example, construed the scope of the now-repealed Fair Trade Law exemptions to the Sherman and Federal Trade Commission Acts. See U.S. v. McKesson & Robbins, Inc., 351 U.S. 305 (1956), and Rubbermaid, Inc., FTC Dkt. No. 8939. (The Fair Trade Laws were repealed by the Consumer Goods Pricing Act, Pub. L. No. 94-145 (Dec. 12, 1975).) Both cases involved resale price maintenance agreements coupled with supplier-imposed customer restrictions.

Notably, the interpretations applied in the fair trade cases cited actually narrowed the fair trade law resale price maintenance immunities. As we noted in Rubbermaid, "... we will construe strictly any provision which deviates from fundamental antitrust policy, for exemptions from the antitrust law are to be strictly construed...." (Slip Opinion, p. 24, fn. 45).

Two cases traceable to McKesson have condemned, as "horizontal," agreements between dual-distributing suppliers and their independent distributors. See Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711 (S.D.N.Y. 1969), aff'd per curiam, 417 F.2d 621 (2nd Cir. 1969) (resale price maintenance and territorial restrictions), cited in Hobart Brothers Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir. 1973). In

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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

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Hobart, the supplier of welding equipment competed with its distributor in the sale of the equipment to other customers. The supplier and distributor were also competitors in the manufacture and sale of continuous wire feeder mechanisms. Efforts by the supplier to police its territorial restrictions, through disparagement and finally termination of the welding equipment distributorship, damaged the distributor's business in the sale of both welding equipment and wire feeder mechanisms. (Id. at 898, 903). The Fifth Circuit found that the territorial restriction in these circumstances operated horizontally. The court also noted in dicta, however, that agreements limiting the area in which other independent distributors could sell Hobart products in competition with Hobart constituted horizontal territorial allocations. (Id. at 899).

In non-fair trade cases, the Supreme Court has not applied the fair trade "in competition" standard in determining horizontality in dual-distribution, territorial restriction situations. Had the standard been applied, for example, in White Motor the restraints before the court conceivably could have been treated as horizontal arrangements; Justice Clark, citing McKesson in his dissenting opinion, argued as much with respect to White's customer restrictions. In fact, White Motor had reserved to itself the business of selling its trucks to certain types of customers located within the "exclusive" territories it granted to its independent distributors, White Motor Co. v. U.S., 372 U.S. 253 (1963). While the per se rule in Schwinn has been overruled, the opinion contains useful guidance for purposes of classifying restraints. Notably, Schwinn shipped bicycles directly to retailers, while paying the order-taking distributor a commission on the sales (Schwinn, supra at 370), and consequently the situation involved substantial participation by the manufacturer in the bicycle distribution chain. The court stated:

> ... we are here confronted with challenged vertical restrictions as to territory and dealers. The source of the restriction is the manufacturer. These are not horizontal restraints in which the actors are distributors with or without the manufacturer's participation. (at 372).

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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. 12/ When it acquired a bottler, The Coca-Cola Company itself became subject to the

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Later in Schwinn the court again emphasized that it was:

> ... dealing here with a vertical restraint embodying the unilateral program of a single manufacturer. We are not dealing with a combination of manufacturers ... or of distributors .... We are not dealing with a "division" of territory in the sense of an allocation by and among the distributors ... or an agreement among distributors to restrict their competition.... We are here concerned with a truly vertical arrangement.... (at 378, citations omitted).

12/ Territorial monopolies, intrabrand, have been a dominant characteristic of respondents' distribution system since the beginning of the Coca-Cola bottling business. Looking back upon respondents' humble origins, exclusive territories may have, as they contend, been necessary to attract local businessmen to invest in their bottling venture. We certainly ascertain nothing in the record which disputes respondents' characterization of the difficulties encountered by those who labored, nearly three-quarters of a century ago, to solicit investor interest in soft drink bottling.

Prior to 1900, bottled Coca-Cola was virtually unknown. At the time, Coca-Cola syrup was sold almost exclusively through fountain jobbers to retailers who performed the function of mixing the syrup with carbonated water, and the finished soft drinks were served, most often for immediate consumption by the consumer, at the retailer's place of business. The demand for Coca-Cola in containers capable of maintaining its effervescence which could be purchased at the store and taken home for later consumption was, in fact, an outgrowth of the fountain business.

A brief survey of the economic landscape of 1900, as revealed in the record, leads us to conclude that businessmen of that era probably considered soft drink bottling little more than a newfangled invention with a questionable future. Having never before been done to any significant degree, it had virtually no financial track record to guide potential investors. Even the management of The Coca-Cola Company at the time had serious

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same territorial limitations it had previously imposed upon the acquired bottler. (Tr. 512-13, 527). 13/ With each

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reservations about its feasibility. Coca-Cola bottling was not an innovation of The Coca-Cola Company; rather, it appears from stipulated record evidence that its then-chief executive probably considered the scheme to bottle the product an undertaking more suited to the taste of adventurous speculators than serious investors.

Thus viewed in its historical context, soft drink bottling was a fledgling industry when territorial exclusivity was originally awarded to Mr. Thomas and others, and, by them, subsequently in smaller parcels to hundreds of local bottlers. In this way, they attracted the manufacturing and distribution capital to develop a new business and to expand the sale of a new product, finished Coca-Cola in bottles, into new markets. In these circumstances, the language in White Motor Co. v. United States, 372 U.S. 253 (1963), quoting from Justice Brandeis in Chicago Board of Trade, is appropriate:

> The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and predict consequences. (at 261).

Evidence concerning the history of respondents' territorial restrictions and the essential relationships which have existed basically unchanged over the years among the respondents and between them and the independent bottlers confirms our conclusion that the restraints on the sale of Coca-Cola are not the off-spring of a horizontal conspiracy or collusive horizontal agreements.

13/ The record shows that there are several types of Coke bottler licensees. (CPF 83). Those bottlers which originally acquired the rights to bottle Coke directly from The Coca-Cola Company or its predecessors are known as parent bottlers. This category now includes only the Thomas Company respondents, the other parent bottlers having been acquired by The Coca-Cola Company. The parent bottlers, in turn, parceled out pieces

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acquisition, then, The Coca-Cola Company merely replaced an independent bottler within a preexisting distribution scheme. 14/ No evidence was introduced that the acquisitions actually changed either the competitive effects of the territorial restrictions or the basic relationships among the bottlers. While it is true that respondents may at times resolve border disputes involving territorial boundaries which occasionally erupt among the 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. See U.S. v. Sealy, Inc., supra. Nor has it been established on this

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of their territory in which they granted exclusive rights to local investors known as first-line bottlers. (CPF 84). Territorial restrictions were imposed upon each of these first-line bottlers by the parent bottlers. In some instances, first-line bottlers have further carved up their territories and have licensed others, known as "sub-bottlers," to bottle Coca-Cola on an exclusive basis.

14/ This conclusion is corroborated by the fact that The Coca-Cola Company entered Baltimore not as a parent bottler, but as a first-line bottler. It operates within the exclusive territory of the bottler which it acquired, and its parent bottler is a Thomas Company. (App. Br. 23, 55). Furthermore, the record shows that several bottling facilities were acquired by respondent to assure product availability in territories in which the independent bottlers were leaving the market and other independents with sufficient capital and know-how were unavailable to take their place. (Tr. 913, 922).

It should be noted that soft drink syrup producers and particularly small manufacturers may be able to enter new markets nationwide to compete with dominant firms like Coca-Cola and PepsiCo by offering exclusive trademark licenses of limited duration to existing bottlers or by encouraging new bottlers into the market. If the search for independent capital is unsuccessful or if an independent bottler decides to withdraw from the market, a syrup company may then decide to integrate vertically in order to preserve its market position. Should it, in fact, integrate under these circumstances, it would, of course, be entering the "bottling level," but we do not read Topco as condemning this type of dual-distribution program as a horizontal market allocation arrangement.

record that the tapestry of Coca-Cola bottling territories is the product of horizontally contrived arrangements among the bottlers actively blessed or passively accepted by any respondent. (See Fontana Aviation, Inc. v. Beech Aircraft Corp., 432 F.2d 1080, 1084 (7th Cir. 1970). 15/

This is not to say that the type of territorial restrictions traditionally considered vertical are devoid of horizontal competitive implications; but on the facts before us, we cannot conclude that the horizontal aspects of these restraints are, for classification purposes, predominant in the Topco sense simply because they now prevent intrabrand competition among independents and Coca-Cola's subsidiaries, whereas previously they functioned as a barrier to intrabrand competition only among independents. In the latter situation and in markets in which respondent Coca-Cola entered the distribution system below the level of a parent bottler, as it did in the Baltimore territory, complaint counsel concede the restraints are vertical (App. Br. 55), and for all that appears in the record, the essential nature of these restraints in instances respecting the distribution of bottled and canned Coca-Cola, despite The Coca-Cola Company's acquisition of parent bottlers, remains vertical. 16/

15/ An aggregation of geographic restraints designed by a franchisor for the purpose of eliminating both intrabrand and interbrand competition between itself and its franchisees may, under certain circumstances, result in a "horizontal" allocation of markets. See American Motors Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230 (3rd Cir. 1975), in which the court concluded that since the franchisor:

> ... in one of its capacities, was dealing on the same market level as its franchisees, its contracts that, in effect, foreclose such franchisees from operating either Holiday Inns or non-Holiday Inns in cities where HI operated an inn, except with HI's permission, constituted market allocation agreements among competitors. (at 1254).

Respondents' bottlers, in contrast, are not prevented from manufacturing or distributing soft drinks trademarked by competing syrup companies; nor do respondents have any control over the geographic area in which its bottler may distribute such products.

16/ In Adolph Coors Company, 83 FTC 174, the Commission considered, strictly in a vertical context, an aggregation of trade restraints, including price fixing and territorial restrictions, by a brewer which distributed its products through independents and "a wholly-owned subsidiary of respondent." (83 FTC at 175).

b. Introduction of New Product Lines by a Dual-Distributing Supplier/ Trademark Licensor

The allied products of The Coca-Cola Company, TAB, Sprite, Fresca, Fanta, and Mr. PiBB were developed by respondent, at least in part, to satisfy the demands of its bottlers for additional soft drink flavor lines. These products were first introduced in the early 1960s, long after The Coca-Cola Company had entered the bottling level, and were offered to the integrated bottling operations and the independent Coca-Cola bottlers alike on an exclusive basis for distribution within their existing Coca-Cola bottling territories. 17/ Allied product licenses were granted by The Coca-Cola Company directly to the bottler. Unlike many of the Coca-Cola licenses, no parent bottlers are involved in these licenses. 18/ Consequently, complaint counsel view the territorial aspects of these allied product licenses as market allocation agreements between potential competitors; specifically, respondent's own bottling subsidiaries and the independent bottlers.

While the allied product licenses are conferred by a manufacturer which also produces and sells finished soft drinks at wholesale to retailers within exclusive territories, absent evidence of collusive activity among the bottlers, we conclude that the introduction of new product lines by a vertically integrated soft drink syrup company using its existing channels of distribution would not, under White and its progeny, necessarily render the bottling agreements "horizontal."

17/ See Tr. 540-41, CX 104A, CX 110A, CX 115A, 119A, 121A (allied product territories of the Baltimore subsidiary); and, for example, CX 199A, CX 202A, CX 206A, CX 207A (allied product territories of the Richmond bottler); CX 256, CX 259A, CX 264A (allied product territories of the Washington bottler); CX 564A, 565A, 566A (allied product territories of the Dover, Delaware bottler). In each instance, the boundaries within which the bottler may produce and distribute the allied product are identical to the territorial boundaries specified in its Coca-Cola license.

18/ The Coca-Cola bottlers were not required to handle the allied products, and many which were already producing soft drinks, made from syrups produced by other syrup companies such as Dr. Pepper or Sunrise flavors, declined the license for certain Fanta flavor lines or Mr. PiBB, Coca-Cola's "Pepper-type" drink.

Since complaint counsel have the burden of proof, we shall assume that the "allied product" trademark licensing programs for each flavor line were conceived by The Coca-Cola Company, acting unilaterally as the syrup and concentrate supplier and trademark licensor. No evidence to the contrary was introduced. The record as a whole does not evidence any collusion among bottlers concerning the allied product territories or that bottlers jointly participated in or exerted any control over the territorial aspects of respondent's allied products distribution scheme. (See GTE, supra at 71,901, fn. 28). Rather, the evidence indicates that respondent, alone, elected to distribute the allied products through the existing network of Coca-Cola bottlers using the Coca-Cola-type licensing system.

While not dispositive of its liability in this proceeding, it is also relevant, for purposes of classifying the restraint as horizontal or vertical, that complaint counsel failed to demonstrate, in any respect, that The Coca-Cola Company's presence at the bottling level substantially altered either the competitive effects of the allied product restrictions or the essentially vertical relationships respondent had with its bottlers before the allied products were introduced. We conclude that Topco is not applicable in this context.

2. Vertical Per Se Theories

As we mentioned previously, the Supreme Court, in overruling Schwinn, has not entirely rejected the possibility that vertical restrictions may, in individual cases, be declared per se unlawful, but it has toughened the standard considerably. Only those restraints found to be "pernicious" and without "any redeeming virtue" now justify per se treatment. The types of competitive situations, other than price fixing, which may meet this standard are unclear, but beyond that, the trier of fact and appellate tribunals must be receptive to the fact that situations may exist in which the imposition of a vertical restraint may, under GTE, still be per se unlawful. 19/

19/ During the pretrial period following issuance of the complaint, complaint counsel's predecessors, citing the Supreme Court's decision in Schwinn, filed with the administrative law judge then assigned to the case a motion for partial summary decision declaring respondents' territorial restrictions per se illegal vertical restraints on the sale of finished soft drink products. The judge denied this motion (See Order Denying Motion by Complaint Counsel for Partial Summary Decision, April 5, 1973); interlocutory review of his ruling was not sought; and the case subsequently proceeded to trial, the vertical per se theory having been abandoned. (App. Br. 3, 5 fn. 1). Amici have revived the theory for consideration on appeal.

On the facts before us, we believe the application of a per se rule would be inappropriate. Taking into consideration the competitive dynamics in this industry, there are important unresolved issues in this proceeding concerning whether open intrabrand competition among the bottlers of Coca-Cola and the allied products would adversely affect interbrand competition in the sale of soft drink beverages. The resolution of these issues in this case, we believe, requires a rule of reason analysis. The burden of proof justifying application of a per se standard has not been met on this record. The territorial aspects of these trademark licensing agreements, or those which may be imposed by other firms in this industry, have not been shown to be typically pernicious and without redeeming virtue under the Northern Pacific 20/ standard, as adopted in Continental T.V., Inc. v. GTE Sylvania, Inc., supra. We now turn our attention to the record.

III. Effects of the Territorial Restrictions

A. The "Corridor Area"

Although respondents admittedly impose territorial restrictions on virtually all of their bottlers nationwide, at the trial, complaint counsel limited their proof of competitive impact to an area of the country extending from southern Virginia to upstate New York, an area which has been referred to in this proceeding as the "corridor area." Complaint counsel believe the "corridor area" is a microcosm of the soft drink bottling industry as a whole; thus if the restrictions are found to be anticompetitive in this geographic area, the findings can, according to complaint counsel, be applied to the competitive situation nationwide. We believe complaint counsel have met their burden of establishing the validity of the "corridor area" analysis. Respondents' objections to it notwithstanding, the business of bottling soft drinks in the "corridor area" is, in fact, essentially no different from the bottling business in other areas of the country.

The record shows that within the "corridor" there are urban, suburban, and rural bottlers with single-plant and multi-plant operations, large and small bottlers, first-line bottlers, sub-bottlers, and marketing bottlers with no production facilities. Several "corridor area" bottlers distribute within a single territory. Others, through consolidations or acquisitions, have obtained the rights to distribute Coca-Cola in two or more territories. The "corridor area" also includes both private and publicly owned bottlers, a bottler-owned canning cooperative, a major bottling and canning subsidiary of The Coca-Cola Company, contract canners, and interbrand competitors. In addition, Coca-Cola bottlers throughout the

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20/ See Northern Pacific Railroad Co. v. U.S., 356 U.S. 1 (1958).

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country may manufacture and distribute, or "piggyback," soft drinks trademarked by competing syrup companies; and in virtually all instances, they use a route or "store-door" delivery system to distribute at wholesale the soft drink products in various package sizes and types which they either bottle themselves or which are produced for them under agency agreements by neighboring bottlers or canners.

While respondents correctly note several perceptible but minor distinctions in the "corridor area" bottling business, those differences are really inconsequential for the purpose of this proceeding. Respondents, for instance, alert us to the fact that the demand for returnable, refillable bottles tends to be higher in other parts of the country than in the "corridor area" where convenience packaging seems to be more popular. (Tr. 1345-46, 2871-72, 2064, 3781, 2368-69). As a packaging alternative, however, refillable bottles are offered in many markets and are an important factor in several bottling territories included within the "corridor area." The record shows that refillables represent 50 percent of the sales of Coca-Cola in bottles and cans in the Richmond territory; 60 percent in Charlottesville; 65 percent in the territory of the Washington, Pa., bottler; 47.9 percent in Westminster, Md.; 41 percent in Dover, De.; and 74 percent in Montrose, Va. (RPF 348). Recognizing, then, that the proportion of soft drinks sold in refillables may be greater in other parts of the country, there is ample use of this form of packaging and sufficient investment by the bottlers in refillable bottle inventories or "float" within the "corridor" to safeguard against any significant distortions in our analysis.

Nor are we persuaded by the argument that the "corridor area" is atypical of the nation as a whole merely because territories may tend to be larger and the population ratio of large and small bottlers may vary in other areas of the country. (Tr. 1336-37, 1345, 3266-67). We believe the record provides ample support for complaint counsel's contention that the "corridor area" represents a reasonable cross-section of the bottling firms which operate throughout the country. Setting aside respondents' protestations and references to insignificant distinctions in "corridor area" bottling, we feel that an accurate assessment of the competitive dynamics in the territories of both large and small bottlers and the interrelationships between bottlers which would, absent the territorial restrictions, be likely to result can be made on this record. Respondents called, as defense witnesses, numerous bottlers from Georgia, Iowa, Texas, California, and other locations beyond the "corridor area." Their testimony is remarkably similar to the testimony of the bottlers situated within the

"corridor," including their assessments of the competitive effects of the restrictions under present market conditions and their estimation of the likely consequences of a Commission order eliminating the restraints. Under these circumstances, we find no basis for dismissing the "corridor area" as too dissimilar to the rest of the country to support an analysis of the nationwide competitive impact of respondents' trade restraints.

B. Suppression of Intrabrand Competition Among Respondents' Bottlers

Respondents acknowledge that territorial restrictions prevent intrabrand competition among their bottlers, but claim this effect is actually procompetitive and necessary in the interest of promoting the overall efficiency and productivity of its bottler network. (Ans. Br. 12-16, 54). Respondents contend, moreover, that the admitted restraint of intrabrand competition is of no concern unless "the restraint is imposed by parties with excessive market power," the "principal indication" of which "is the ability to set the price for a product free from the influence of interbrand competition." (Ans. Br. 45, 47). On this premise they further contend that the evidence does not show that respondents have "unrestricted market power" with respect to price, packaging, or service (Ans. Br. 47), and that evidence concerning market share and profits does not demonstrate that Coca-Cola has "dominant or monopoly power." (Ans. Br. 49). Implicit in this contention is the idea that absent such market power the asserted efficiency and productivity benefits of restrained intrabrand competition will be passed on to the consumer as a result of interbrand competition.

We do not agree that a showing of "dominant or monopoly power" or "unrestricted market power" is necessary before it may be concluded that suppression of intrabrand competition is unreasonable and in violation of Section 5. Respondents and the ALJ cite the decision in United States v. Columbia Pictures Corp., 189 F. Supp. 153 (S.D.N.Y. 1960), where the court made the following summary of the doctrine of ancillary restraints (id. at 178):

> It permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the marketplace; and (3) is not imposed by a party or parties with monopoly power.

Thus, the court did not hold that market power must be demonstrated before a restraint could be held unreasonable under the Sherman Act, but rather held only that the absence of monopoly power was

one of several prerequisites before a restraint might be held reasonable. Indeed, in GTE the Court indicated that even a less sweeping restraint on intrabrand competition than we have before us here could be found unreasonable without a showing of market power, even though the company imposing the restraint had a small market share and was far removed from the dominant firm in the industry. GTE, supra at 71,893.

While the territories in which Coca-Cola and the allied products are sold are not devoid of interbrand competition, nevertheless Coca-Cola and allied product prices have great competitive significance in the marketplace. 21/ Moreover, the record amply demonstrates that respondents' territorial restrictions constitute a serious impediment to free market forces and diminish competition in the manufacture, distribution, and sale of several important soft drink product lines. The record also shows that intrabrand competition would invigorate price competition which would be likely to produce lower wholesale prices for Coca-Cola and the allied products. (Tr. 739, 887-889, 992-93, 1568, 2459, 2885). By suppressing the development of intrabrand competition in the sale of these products packaged in bottles and cans, the restrictions have, over the years, distorted the competitive dynamics of the industry, and have disrupted the natural economic forces which would have, in the absence of restraints, caused an evolution in the geographic market boundaries of respondents' bottlers.

21/ The complaint in this matter defines soft drink products as including non-alcoholic beverages and colas, carbonated and uncarbonated, flavored and non-flavored, sold in bottles and cans, or through pre-mix and post-mix systems, or the like. (Complaint para. 1(h)). Within this broad product market definition, however, there may be a number of relevant submarkets. For example, in Sulmeyer v. The Coca-Cola Company, 515 F.2d. 835, 848-49 (5th Cir. 1975), the court found that a lemon-lime flavor segment of the soft drink market was a relevant submarket and, further, that all independent bottlers, as urged by The Coca-Cola Company in that case, constituted a relevant market. We note, however, 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. The trial did not focus on structural characteristics in various arguably valid submarket categories; nor did it isolate the competitive effects of these restraints within strict submarket contexts. In a light most favorable to respondents, a record of competitive impact was developed in the context of virtually every liquid, except alcoholic beverages, a person may consume. Particular emphasis however, is placed on flavored carbonated soft drink beverages since virtually all of the bottlers tended to place their emphasis on these beverages in describing competitive products which influence their business decisions.

Before we consider whether these restraints promote interbrand competition and efficiencies in distribution, as respondents contend, we must take a closer look at the intrabrand effects of the restraint.

1. Intrabrand Syrup Jobbers

Respondents argued below and again on appeal 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 syrup sold by independent wholesalers for use primarily at soda fountains and in cup vending machines. (RPF 171-72, IDF 133-34). While the bottlers distribute the packaged finished soft drinks within exclusive territories, a syrup jobber is free to sell post-mix syrup in any geographic market in which a demand for the syrup exists to any customer who has a proper use for it. Several independent wholesalers may compete in the sale of post-mix syrup in any given area, including a few bottlers of Coca-Cola who also wholesale the post-mix syrup primarily to the cold drink trade and, like the jobber, may independently decide where and to whom they will distribute it. (RPF 171, Tr. 1941).

In his initial decision, the judge, without qualification, found that intrabrand competition between jobbers of post-mix syrup and the bottlers of packaged finished soft drinks is indeed "vigorous." Only by ignoring relevant supply and demand factors, including the fact that the bottler sells a packaged product which is frequently purchased by the consumer in quantity and stored at home for later consumption, would this conclusion be sustainable. (See Tr. 2384-85, 1684).

The soft drink bottling industry grew out of the business of selling syrup to soda fountain retailers, but it has always been viewed by respondents and the bottlers as a different business. (Res. Ans. Br. 3-5, 10-11; Tr. 1572-73, 3262). See The Coca-Cola Bottling Co. v. The Coca-Cola Co., 269 F. 796 (D. Del. 1920)). This is evidenced by a relationship between The Coca-Cola Company and its bottlers predicated on the distinction between syrup sales to retailers who serve soft drinks to consumers for on-premise consumption and the sale of packaged finished soft drinks to retailers who resell it to consumers for home consumption. This distinction is as valid today as it was when respondent Coca-Cola sold its rights to manufacture and distribute bottled Coca-Cola to Messrs. Thomas and Whitehead.

Admittedly, for certain types of soft drink retailers, there is a viable option to purchase either finished packaged soft drinks from a bottler or post-mix syrup which they can mix with carbonated water just as a bottler would, but the choice is really available only to retailers, such as restaurants, fast-food retailers, cafeterias, sports stadiums, and

other types of outlets which serve Coca-Cola in cups, bottles, or cans for immediate consumption. (Stip. No. 3, CX 1244-1). Competing for these accounts against the Coca-Cola post-mix wholesaler, however, a bottler is at a serious disadvantage precisely because he is selling a finished packaged product.

Unlike the bottling and canning of Coca-Cola and other soft drinks, post-mix wholesalers are not required to perform any of the manufacturing functions a bottler performs. Nor is the wholesaler required to provide any dispensing equipment or service and often he does not perform any delivery functions since the post-mix syrup is frequently drop-shipped by The Coca-Cola Company directly to the retail customer.

The record further shows that fountain syrup is often incidental to the bottlers' overall business to the point that they make no effort to sell it. Mr. Navarre, Chairman of the Boards of the Coca-Cola Bottling Co. of Miami, the Delaware Coca-Cola Bottling Co., and the Coca-Cola Bottling Works of Havre de Grace, Maryland, testified about the fountain syrup business:

> Q. -- I believe you stated that you don't sell fountain syrup -- why have you elected not to? Is there a contractual part of your doing so?
>
> A. No, sir, it is a competitive situation and ability to be able to furnish to these dealers at this price and the profit contribution under our form of doing business is not sufficient to interest me. (Tr. 1554-55).

Conversely, in selling to other types of outlets, such as retail food stores which cater to a substantial market for Coca-Cola and the allied products in take-home packages, the bottler need fear no intrabrand competition from any of the post-mix wholesalers. This comports with the basic rationale of the soft drink bottling industry. (See Tr. 4080-81). In fact, the entire bottling industry exists because of its ability to service the demand for soft drinks in take-home packages which the fountain syrup wholesalers have never been able to reach. (See Tr. 1457). Consequently, in the sale of soft drinks in bottles and cans for home consumption, which the bottler alone is uniquely equipped to serve, intrabrand competition from post-mix wholesalers is virtually nonexistent. Mr. Navarre's testimony amply demonstrates 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, and even as limited, there will be competition between bottlers and jobbers only if the bottler elects to expand into the cold drink trade. Thus a bottler may, in some instances, actively solicit cold drink accounts, but jobbers are, by the nature of their product, foreclosed from competing for the bottlers' take-home business.

Contrary to the judge's finding, then, it is evident there is virtually no direct competition between syrup jobbers and bottlers for the bulk of the bottlers' business to their traditional food store and other accounts which serve the consumer demand for Coca-Cola, TAB, Sprite, Fresca, and other allied products in take-home packages.

2. Territorial Restrictions Prevent Procompetitive Geographic Market Expansion and Eliminate Potential Competition

Complaint counsel contend that respondents' territorial restrictions, rather than fostering greater efficiency, actually deter progress and the efficiency of the bottlers because they prevent the type of production and sales expansion which would enable bottlers to achieve maximum scale economies and further prohibit or discourage the bottlers from taking maximum advantage of improved production, distribution, transportation, and communications systems developed in the last five decades or so. (App. Br. 57). Respondents vigorously dispute each of these contentions. In their view, bottlers large and small have been able to adapt to changing economic conditions, to expand their sales within their territories, and to employ innovative techniques of marketing and packaging. (Ans. Br. 81).

Respondents are correct in their assertion that many of the adaptable technological breakthroughs of the 20th century have not bypassed the bottling industry. Bottling territories were originally parceled out at a time when bottling facilities used manual equipment and finished soft drink products were delivered in horse-drawn wagons over dirt roads. (Tr. 681, 1656-59). Today, in contrast, even the small bottler uses modern delivery trucks (RPF 292), and unlike his predecessor, he operates on a much more efficient production-line basis, using automated equipment which cleanses containers and purifies and carbonates water. He has mechanized systems which mix the syrup and water, fill and cap the bottles, and package the filled containers at varying speeds depending upon the bottle size and the type of bottling equipment used.

These modern automated production lines have, in addition, increased the potential production capacities of both large and small bottlers. At present, soft drink bottlers often produce and distribute, or "piggyback," the soft drinks trademarked by several syrup companies and may, at times, distribute these brands in exclusive territories of various sizes assigned to them by different syrup companies. (See Tr. 3078, 3063-65, 3067, 3236). Some Coca-Cola bottlers are also capable of supplying, in addition to the soft drink requirements within their own territories, the requirements of other Coca-Cola bottlers who have retained a territorial monopoly for the distribution of Coca-Cola but have temporarily discontinued producing it themselves (Tr. 529-30, 555, 788-89); other bottlers have entered

into agency arrangements to supply neighboring bottlers with their requirements for certain package sizes 22/ or have, by consolidations and mergers, combined their territories, efficiently serving from one production center an area previously serviced by two separate bottling facilities.

Originally, the bottlers' territories probably represented a rather close approximation of the geographic boundaries which would have existed in the industry if natural economic forces were left unrestrained. While territories were granted in various sizes and shapes, they probably encompassed an area roughly measured by the distance a turn-of-the-century vehicle could travel in one day. (Tr. 681). Given the technological and transportation limitations of the late 19th and early 20th centuries, under which the original bottlers operated, it seems reasonable to conclude that most territories probably covered an area not significantly smaller than the Coke bottler was capable of servicing efficiently and effectively. As time passed, however, the potential for direct competition among respondents' bottlers grew as automated production of soft drinks replaced manual bottling lines, as new types of packaging were introduced, and as truck transport and road surfaces improved. Despite these advancements, however, respondents' territorial system stands impervious to natural geographic market evolution and procompetitive market extension by independent bottlers.

3. Territorial Restrictions Indirectly Lessen Competition in the Delivery Services Bottlers Offer to Their Customers

The record also shows that the restrictions impede the bottlers' ability to respond to the demand for competing delivery services. Since the beginning of the Coca-Cola bottling business, the bottlers have used, almost exclusively, a route-delivery system (or store-door delivery as the bottlers refer to it) which entails frequent, direct delivery by the bottler to each of the customer's retail outlets. In the early days of this business before the chain store, central warehouse era of the 1930s and

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22/ The small Pepsi bottler in Dyersburg, Tennessee, also piggybacks Dr. Pepper and Bubble-Up and, working overtime, was still able to supply larger bottlers, including the large Memphis Dr. Pepper bottler, a subsidiary of RKO, with Dr. Pepper in 32-ounce returnable bottles for ten months. Similarly, the Coke bottler in Las Cruces, New Mexico, supplied the Coke bottler in San Antonio with 64-ounce nonreturnable bottles of Coca-Cola for a period of four months (RPF 253; Tr. 2483-84, 2511-12), and the small Northern Neck, Va., Coca-Cola Bottling Co. supplied Coca-Cola in 32-ounce returnable bottles to other bottlers, including the large Crass organization in Richmond. (Tr. 1635-36).

the introduction of nonrefillable containers in the mid 1950s 23/, there may have been few competitive alternatives to store-door delivery. Today, as a result of soft drink packaging innovations, improvements in transportation, and the widespread use of central warehouse facilities by retailers and independent wholesalers, there is a market for service options, such as central warehouse delivery and plant pick-up by central warehouse and other customers and respondents' bottlers have the capacity to exploit it. 24/ Yet, notwithstanding the demand for these competitive delivery services, a bottler may not, consistent with respondents' territorial policy, ship to central warehouses or allow plant pick-up in instances which will result in distribution of the product by the customer outside the bottler's territory. (RPF 49).

While the bottlers who appeared at the trial testified that they prefer store-door delivery to central warehouse delivery because it promotes deep market penetration and allows them to maintain some measure of control over the way the product is merchandised by the retailer on the retail shelves (See also RPF 49), it also appears that store-door delivery is preferred today by many bottlers, at least in part, because it is completely compatible with the preservation of exclusive

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23/ Pressure from competitive packages forced The Coca-Cola Company in 1955 to abandon its single-package (6 1/2 oz. returnable, refillable bottle) philosophy and authorize the bottlers to use various size refillable bottles and nonrefillable bottles and cans. (Tr. 714, 1344).

24/ Central warehousing involves the purchase of soft drinks by the warehouser directly from a bottler or canner for delivery into the purchaser's warehouse. Subsequently, redelivery of the soft drinks is made in the warehouser's own trucks to the warehouser's retail outlets. Warehousers may themselves be retailers (such as large chain supermarkets) who buy for redelivery to their own outlets in their own trucks, or independents who buy for redelivery to non-affiliated outlets or retailer warehouses.

Although the agreements between respondents and the bottlers do not directly prohibit warehouse delivery, respondents concede that the bottlers may not sell Coca-Cola and the allied products to central warehouse customers or allow plant pick-up where the result would be redistribution of these products outside the selling bottler's territory. (RPF 47-49). As a consequence, respondents' territorial policy has indirectly but effectively blocked the development of these alternative modes of delivery.

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territories. (Tr. 1901). 25/ In fact, respondents and the bottlers concede not only a strong market demand for central warehouse delivery and plant pick-up by central warehouse customers (RPF 88-90), but also that some bottlers would

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25/ Respondents and complaint counsel have joined issue over the comparative efficiencies of warehouse delivery and route delivery. A study of both methods of distribution prepared by respondents' expert, Mr. Cowart, shows that the average costs of delivering soft drinks packaged in nonreturnable bottles and cans are approximately the same for route delivery or warehouse delivery. Mr. Cowart's testimony indicates, for example, that the average cost of delivering 32-ounce nonreturnable bottles through warehouses would be 9.6 cents more per case than the cost of current store-door delivery. (Tr. 3438-39). A case of cans is an ideal package for central warehousing because cans are a compact, low-cubage container. Here average costs vary from 3-5 cents in favor of the warehouse in different parts of the country; and if merchandising the product is included in the cost, the warehouse advantage would decline to an average of about .06 cents. (Tr. 3361-62, 3348; RPF 319).

While we cannot conclude on the basis of a study of average costs that central warehousing for soft drink products is more efficient than store-door delivery in all cases, neither is such a study indicative of actual costs in individual competitive situations involving different warehouses, bottlers, and package types and sizes. Route delivery may at times be more efficient than central warehousing for the distribution of large-volume containers such as the 64-ounce bottle; at times it may be a less-efficient method of distribution for soft drinks packaged, for example, in cans. In some instances, then, territorial restrictions may tend to rigidify delivery inefficiencies which a bottler free of the restraint may avoid.

Of course, the complaint in this matter does not challenge route delivery as a method of distribution under any circumstances, including those in which its efficiency is suspect. We are concerned only with the practice of restricting territories, a secondary, indirect effect of which is to inhibit the bottlers from freely competing with respect to the delivery services they may offer depending upon the competitive situation and their own assessment of how best to respond to it. (See Tr. 2786-87, Compare Tr. 3497-98 with Tr. 3532).

provide a competitive response to this demand were they free to do so. (Ans. Br. 55). 26/ Consequently, by hindering central warehouse and plant pick-up delivery, territorial restrictions impede the development of an important aspect of competition in the types of delivery services bottlers would offer to their customers in advantageous competitive situations. 27/

4. Territorial Restrictions Deprive Retailers and Consumers of the Benefits of Open Intrabrand Competition

Complaint counsel introduced into the record as part of their case-in-chief evidence which shows that the bottlers are not always able to adapt to changing economic conditions and improved technology in marketing and production to achieve efficiencies, especially if their initiatives are inconsistent with respondents' territorial policy. At the same time, the evidence shows that the restriction prevents any intrabrand

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26/ It has been suggested that the store-door method of product delivery is inconvenient for some of the bottlers' customers. See Tomac, Inc. v. Coca-Cola Co., 1976-2 Trade Cases, ¶60,988 at 69,381-82. However, there is more at stake here than the convenience of some customers. In U.S. v. Aluminum Co. of America, 148 F.2d 416 (2nd Cir. 1945), Chief Judge Hand, commenting on the purposes of the Sherman Act, noted:

> ...that the spur of constant (competitive) stress is necessary to counteract the inevitable disposition to let well enough alone ... that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for savings and new shifts in production, and be eager to profit by them.

As the record in this proceeding indicates, at times respondents' territorial restrictions may necessitate a more costly and less competitive method of delivery than those which may evolve in an open market.

27/ As we observed in Coors, in a competitive free enterprise system, the decision to exploit the advantages of route delivery or central warehouse delivery:

> ... should be left to the free, unimpeded play of market forces and the respective, independently exercised judgments of the relevant units of distribution. (at 202).

competition, including price competition 28/, in the sale of

28/ That the restraint has severe adverse effects on price competition is abundantly demonstrated in the testimony of James Wimberly, Vice President of Coca-Cola U.S.A. In response to Judge Dufresne's questions, he testified that:

> ... the experiences that I recall, sir, would only result when maybe one bottler raised his price and an adjoining bottler did not at that point in time, and customers or dealers would try to bring Coca-Cola from one territory to the other.
>
> Judge Dufresne: The fellow who raised his price reported to you?
>
> The Witness: Yes, sir, sometimes, that is right, they did.
>
> Judge Dufresne: And what did you do about it?
>
> The Witness: I generally said two things: One is if we do anything about it we have got to be sure that it occurred, and that we are dealing with facts; and, secondly, on some occasions I went to the bottler in whose territory it was reported the merchandise was coming from to try to get him to talk to their dealers or salesman to persuade them not to do that.
>
> Judge Dufresne: Suppose he says, Mr. Wimberly, I don't care what you say. I am going to sell this Coca-Cola to anybody who comes to my door and says, I don't want to pay Charley's prices in the next territory?
>
> The Witness: Well, yes, sir, but you see, most of the time the bottler who allegedly was purportedly involved in that, that one whose territory that the Coca-Cola was coming from, in most instances he was eager not to continue that sort of practice either because he felt pretty sure if he did, the other Coca-Cola bottler was going to try to do the same thing in his territory, and it would just lead to --
>
> Judge Defresne: He could be persuaded to discontinue it. Is that what you are saying?
>
> The Witness: In most instances they realized that that would lead to great trouble and bickering and fighting between them and were pretty anxious to discontinue --. (Tr. 887-89).

Coca-Cola and allied products in bottles and cans. As a consequence, respondents' restrictions are, as alleged in the complaint, depriving retailers and consumers of the opportunity to purchase Coca-Cola and the allied products in bottles and cans in unrestricted markets at openly competitive prices. Moreover, these restrictions have repressed the freedom of independent bottlers to expand their businesses or to seize opportunities they may perceive to increase their output of Coca-Cola and the allied products by selling these products where and to whom they choose in markets governed by natural economic forces.

IV. Consideration of Respondents' Arguments Supporting the Elimination of Intrabrand Competition

In concluding that the type of transaction, *i.e.*, sale or consignment, a manufacturer uses to distribute a product "is not sufficient to justify the application of a per se rule in one situation and a rule of reason in the other," the *GTE* court noted that post-sale vertical restrictions may not always be without redeeming virtues. For example, the Court pointed out that vertical restrictions may promote interbrand competition by inducing capital investment and promotional and service activities by the supplier's customers, by increasing marketing efficiency, and by improving quality control. (*See GTE* at 71,900-901). While the Supreme Court did not indicate that lower courts should afford such inducements and efficiency factors dispositive weight, its opinion clearly makes the consideration of these issues relevant in determining whether the restraints are reasonable.

A. Capital Investment

Respondents contend that territorial restrictions promote the business purposes of The Coca-Cola Company because the soft drink industry is capital intensive and the restraint creates a climate conducive to capital investment. While it is true, as respondents contend, that exclusive territories provide bottlers with a measure of certainty with respect to their ability to recover their investments (RPF 73), we are unable to conclude, on this record, that a free market would otherwise render the bottlers incapable of operating at a profit.

The fact that the risks which attend a bottler's efforts to recover his investment would increase without territorial intrabrand monopoly protection is simply a corollary to the conclusion that as competition intensifies, business risks of capital recovery increase to the entrepreneur. While capital investment considerations, as we have previously noted, 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. (Compare Tomac, supra at 69,381). In competitive markets, prices may be expected to reflect the capital requirements of the firms in the industry in addition to providing entrepreneurs a fair return on their investments. 29/

Shielded by artificial trade barriers created by The Coca-Cola Co., bottlers may well feel secure in making investments which might seem unwise to them if their decisions were being fashioned by free market demands; but this is further evidence of the significant degree to which competition may be lessened by these restraints. Here territorial restrictions are not serving the interests of competition in aid of an aspiring new entrant or a failing or faltering firm which cannot otherwise find investors to put up the distribution capital necessary to market its product. In this instance, the restraint is reducing the entrepreneurial risk of investment by lessening competition among the firms which wholesale one of the most

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29/ Evidence of the profit bottlers realize on the sale of Coca-Cola or the allied products is in a state of disarray. To begin with, profit is variously described by different bottlers as dividends on book value or as a return (1) on sales, (2) on book value, (3) on investment, (4) on invested capital (5) after taxes on the replacement value of investment, (6) on the market value of investment, and (7) on equity. For all that appears in the record, each bottler may calculate profits on a different basis. Moreover, seven of the ten witnesses, relied upon by respondents in support of their contention that the profit levels of their bottlers are reasonable (RPF 266), piggyback brands other than Coca-Cola and the allied products. Profit on the sale of Coca-Cola products by these bottlers is not indicated. There is, as a consequence, little basis for a comparison of the profitability of Coca-Cola bottling with other industries; nor do we find support for the conclusion that the return obtained by bottlers on the sale of Coca-Cola and allied products is not "abnormal" when compared with other industries. (RPF 265). Furthermore, the profitability of respondents is not reflected in the record.

If respondent were a new entrant or a failing or faltering firm, profitability might be a relevant consideration in assessing these restrictions. However, we find it difficult to justify the restraint, in this instance, as a means of improving respondents' profits or those of its bottlers.

popular consumer product lines in American industry. (Tr. 685). 30/ While intrabrand competition may reduce the profit in bottling Coca-Cola and allied products, respondents' failed to establish that these prized trademarks and premium products would not still remain viable interbrand competitive factors in an open, unrestricted marketplace. As such, we cannot sanction anticompetitive conduct for the purpose of allowing respondents' bottlers to continue, in perpetuity, to make capital-investment decisions in response to the distorted economic forces within their exclusive territories.

B. Availability and Market Penetration

By using route delivery in exclusive territories, the bottlers have maximized their market penetration and the availability of Coca-Cola, putting it in every conceivable location a soft drink may be sold and placing it within "arm's-reach of desire." (Tr. 696). Numerous bottlers testified that deep market penetration and product availability are crucial to selling soft drinks in bottles and cans successfully. (RPF 77). This marketing philosophy has led the bottlers to service large numbers of vending machine accounts, small outlets, and "special events" which they claim are unprofitable. (RPF 83). Many of the bottlers who engage in these types of unprofitable activities do so, they say, to obtain "paid sampling" of their products "to get the product awareness to make the larger accounts profitable. It is a matter of developing a market, training people to drink Coca-Cola." (Tr. 1454). In the opinion of the President of The Coca-Cola Company, territorial restrictions encourage this type of market penetration because "(t)he fellow who has a limited field to till obviously has to till it better in order to get the most out of it." (Tr. 696, RPF 84).

The record does not indicate whether The Coca-Cola Company consistently sells syrup unprofitably to some of its bottlers as its bottlers sell unprofitably to a large number of accounts presumably to create a demand for Coca-Cola; but it would not be second-guessing the bottlers' business judgments to observe that The Coca-Cola Company may be "free riding" on the volume generated by its independent bottlers' give-aways and unprofitable sales. The Coca-Cola Company, in selling the syrup and

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30/ Evidence in the record indicates that Coca-Cola bottlers are firmly entrenched in the fabric of the bottling industry and that their Coca-Cola brand alone is often a leading brand in their territories. This is reflected in a stipulated survey of 36 cities, from Maine to California, in which Coca-Cola, as a single brand, consistently ranked among the top four brands in each city. (RX-2Y-Z38, See Tr. 2691).

concentrate soft drink ingredients to its bottlers, profits by the expanded sales universe of its bottlers, even if that universe includes accounts which are unprofitable to the bottlers. 31/

At the same time, a bottler typically charges a uniform or level price to all of his customers irrespective of the fact that price differences between customers may be justified on the basis of different delivery costs the bottler incurs in serving each outlet. Consequently, some accounts which may cost the bottler less to service probably contribute a disproportionately higher share of the overall cost of the bottler's market penetration. (Tr. 4043). And eventually, those retailers who may be paying or "subsidizing" part of the costs associated with deliveries to other retailers will pass on to consumers, in the form of higher prices, any added cost they may be absorbing. (Tr. 4042).

31/ The Court in GTE noted that vertical restrictions may increase economic efficiency because the manufacturer desires to minimize his cost of distribution and to encourage dealers to sell at "the lowest retail price possible * * * because a lower retail price means increased sales and higher manufacturer revenues." 1977-1 Trade Cas. Para. 61,488 at 71,901, n. 24, citing Note, 88 Harv. L. Rev. 636, 641 (1975).

The trademark license to bottle and sell Coca-Cola contains a fixed syrup price which can change only in accordance with a formula tied to the price of sugar. (CX 9A-G, CX 11A-B, CX 13A-B). Hence, The Coca-Cola Company can raise its syrup price vis-a-vis bottlers only when sugar prices rise. The fixed syrup price means that The Coca-Cola Company cannot profit from higher prices charged by bottlers for Coca-Cola. Only more syrup volume produces more profit. (Supplemental Br. of Intervenors Coca-Cola Bottling Co. of L.A., et al., at 6). It is not possible on this record to state definitely whether the bottlers' market penetration in exclusive territories generates greater syrup and concentrate volume and profit for The Coca-Cola Company than would intrabrand competition among bottlers, but the latter probably would, in many instances, result in lower wholesale prices for the finished soft drinks.

It should be noted that several witnesses testified that while wholesale prices in open markets would probably be lower for some customers, they might be higher for other customers. As we noted in Boise Cascade Corp., Dkt. No. 8958, issued January 11, 1978:

> By 'lower' (prices) we do not mean simply lower for all customers. Elimination of restraints of trade may result in raising prices to some purchasers (perhaps those whom it is costlier to supply) while lowering them to others. In a freight intensive industry the reallocation might occur roughly along lines of relative actual freight costs. (at 6 fn. 4).

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We acknowledge that the elimination of exclusive territories may force the bottlers to abandon their level pricing policies and begin to charge prices which reflect the actual cost differences in servicing various retailers. A bottler who elects to compete for accounts in neighboring territories or who is forced to defend against the forays of intrabrand rivals which seek the business of his previously captive outlets will no doubt lose the leverage of intrabrand monopoly to extract a price from some retailers which reflects the cost of market penetration to other retailers. Consequently, if the degree of market penetration respondents now enjoy fails to reflect actual costs of servicing each customer, it is likely that some adjustments will be necessary: level pricing may give way to pricing which more closely approximates costs, or bottlers may establish a minimum volume which they will deliver to customers, or they may encourage plant pick-up by customers who cannot be serviced efficiently. But the marketplace would benefit from the increased competition, and we cannot conclude that respondents' interests in maintaining the status quo supercedes this consideration.

C. Advertising at the Local Level

Respondents also contend that a bottler's interest in advertising and promoting Coca-Cola at the local level will subside if another bottler selling the same brand can take advantage of his efforts. Exclusive territories prevent this type of "free riding," and thus encourage Coca-Cola's promotion at the local level.

Recently, the court in GTE noted that the extent to which vertical restraints on intrabrand competition alleviate market imperfections such as the "free rider" effect and promote interbrand competition may be a relevant consideration in assessing the reasonableness of a vertical restriction. Further guidance on this issue was provided in Bates v. State of Arizona, __ U.S. ___, 1977-2 Trade Cases, ¶61,573. In Bates the court observed that "where consumers have the benefit of price advertising, retail prices often are dramatically lower than they would be without advertising." (at 72,330). The court further noted in Bates that advertising may facilitate entry by a newcomer seeking to penetrate the market. (at 72,331). Under certain circumstances, price advertising, brand enhancement or image advertising by a new entrant, for example, and advertising which informs consumers about distinct product attributes may, to a greater or lesser

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The testimony in this proceeding reflecting the likelihood that prices might rise for some customers and be lower for others absent the restraint is consistent with our observation in Boise about the workings of a competitive market. In this instance, the free market would be likely to provide those retailers who are efficient not only the opportunity to buy Coca-Cola and allied products from competing bottlers at prices which more accurately reflect costs but also the option to pass on to consumers the benefits of their efficiency.

degree, enhance the competitive vigor of a market. 32/ In this instance, however, the burden of the restraint exceeds the benefits of the advertising it is said to encourage. After 75 years of advertising by respondents and the bottlers, the record clearly shows that it is intrabrand competition which is likely to produce the pressure necessary to reduce the wholesale price of Coca-Cola. 33/ (See text at 51-54 infra).

Unlike GTE and Bates, which involved advertising by those who offered goods or services to ultimate consumers, respondents' bottlers usually sell their products to retailers. As wholesalers, the bottlers admittedly have no control over retail prices charged by their customers. In contrast, Sylvania's retail dealers, like the lawyers in Arizona in the Bates case, advertise prices to their immediate customers.

32/ It has been argued that territorial restrictions cure the "free rider" problem, and thereby promote advertising and merchandising efficiencies at the local level. It is not inconceivable, however, that the pressure of intrabrand competition might encourage bottlers to increase their overall efficiency by cutting costs associated with advertising and merchandising beyond that which the free market might demand. (See Bates, supra at 72,331, fn. 35).

33/ In this instance, we recognize that intrabrand competition may well have an effect on the types of merchandising and advertising a bottler may elect to provide to his customers in response to the types of merchandising efforts customers and consumers demand from the bottler. Presumably some customers would elect to purchase from a bottler offering lower prices and fewer merchandising services if a choice between lower price or increased merchandising were available. Conversely, in exclusive territories a bottler arguably gains a "free ride" on consumers who may end up paying for any excessive advertising, merchandising, or local sales efforts which would be discouraged in favor of price competition. As the Supreme Court observed in Northern Pacific Ry. Co. v. U.S., supra, the antitrust laws rest:

> ... on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were the premise open to question, the policy unequivocally laid down by the Act is competition.

Thus, the potential efficiency-creating aspects of a practice which substantially diminishes competition cannot, on alleged efficiency grounds alone, always be justified under Section 5 of the Federal Trade Commission Act.

Between the bottlers and consumers, however, an additional independent retail level of distribution usually intervenes. (Compare RPF 218 with Tr. 2496). Consequently, bottlers may only suggest retail prices, and while this may indirectly influence the retailers' pricing decisions, we do not consider suggested price advertising a substitute for intrabrand competition at the wholesale level which results in lower wholesale prices and, in turn, competition among retailers which results in lower retail prices. (Compare RX 5, RX 56, 58-61 and RX 101 (advertising by bottlers, Tr. 1982-83, 2493, 2497, 3031) with RX 57A-57Z, (advertising by retailers, Tr. 2496)). As the court observed in Bates: "advertising is the traditional mechanism in a free-market economy for a supplier to inform a potential purchaser of the availability and terms of the exchange." (at 72,330). The record, in this instance, leaves little doubt that the bottlers would have every incentive to price promote their products in competition with intrabrand bottlers and to convey information relating to the terms of sale or the competitive packaging or service alternatives they may offer to their potential purchasers, the soft drink retailer. (See RX 62, Tr. 2500). In fact, the amount of such information received by the potential customers of competing intrabrand bottlers would probably increase. The free rider problem is not likely, for example, to prevent a Coca-Cola bottler from advertising to retailers that his price is lower than that of his intrabrand competitors or that he offers them various delivery options or credit terms. Nor can we conceive of any reason why retailers who purchase their soft drink supplies from competing intrabrand bottlers would lack the incentive to convey similar information to their customers, the ultimate consumer. 34/

34/ Of course, advertising by bottlers may sometimes convey information useful to consumers. For example, an ad in the "San Antonio Light" sponsored by the San Antonio, Texas, Coca-Cola bottler on December 3, 1970, which discussed the merits of refillable bottles may have been useful to some consumers. (RX 60, Compare Tr. 2915). It is in this regard relevant, however, that consumer organizations have filed a brief as amici urging the Commission to lift the territorial restriction despite the advertising "free rider" problem. (See Bates, supra at 72,331 fn. 35). Moreover, advertising is discretionary even by a bottler protected by territorial restrictions. He may choose not to advertise at all or he may direct his advertising to product attributes with which consumers are generally familiar (Tr. 2915) or that consumers may learn about, without incurring significant search costs, through advertising by The Coca-Cola Co. or by retailers or from other sources in the marketplace. Thus the value to consumers of advertising by the bottlers is highly speculative. We are, therefore, unable to conclude that advertising by bottlers which may on occasion convey information potentially useful to comparative shoppers (see RX 60; Tr. 2499; see also RX 56, 61 and 101), out-weighs the sacrifice of intrabrand competition, in perpetuity.

Although bottlers may be reluctant, absent territorial exclusivity, to engage in brand enhancement or image advertising which may be especially susceptible to same-brand free riders, it is highly unlikely that consumer recognition of the Coca-Cola and allied product brands would fade appreciably as a consequence. The Coca-Cola Company, an established giant in the industry, has not shown itself to be in need of financial assistance to promote these brands. Unlike the situation in Sandura Co. v. F.T.C., 339 F.2d 847, 854, 858 (6th Cir., 1964), this record does not show that The Coca-Cola Company must depend upon its bottlers for funds to sponsor national, regional, and local level advertising. This, then, is not a case in which the restraint is promoting interbrand competition by aiding a new firm to enter the soft drink industry or by helping to forestall the exit of a failing or faltering firm as in Sandura. According to its President, Coca-Cola: "... is the most widely recognized name in American commerce and indeed in world commerce ... it has huge value." (Tr. 685). We conclude, in this instance, that advertising-related considerations which may justify the restraint in the interest of fostering interbrand competition by new or faltering firms do not apply here.

D. Quality Control

Respondents contend that territorial restrictions promote product quality in essentially two ways. Because a bottler has a limited geographic area, respondents submit that he cannot afford to risk losing customers who become dissatified with the quality of his product. The restrictions presumably induce bottlers to manufacture a high-quality product and then to ensure that it is subsequently stored and merchandised in a way which prevents the buildup of stale inventory at retail outlets. (RPF 126, Tr. 762, 699). Respondents also contend that the restrictions enable them to monitor, at the retail level, the quality of the product produced by each bottler.

1. In Manufacturing

To ensure that bottlers are properly preparing the finished soft drink products, The Coca-Cola Company has a Quality Control Department which inspects, on an average of three to four times a year, every bottling and canning facility which manufactures Coca-Cola and allied products. Its inspections are generally unscheduled and unannounced and include water analysis, bacteriological checks on water and processing equipment, bottle washing solution checks, sanitation monitoring, and finished product syrup content and degree of carbonation. In addition, each production facility is required monthly to submit product samples for analysis by respondent Coca-Cola's quality control lab. (RPF 121). In this way, The Coca-Cola Company frequently and routinely monitors the bottlers' manufacturing process to ensure that they are producing soft drinks in accordance with its standards of quality. (See Tr. 2669). Contrary to respondents' contentions, however, there is really no connection between these types of quality control inspections and the areas where independent bottlers sell the finished product; plant facilities can be inspected regardless of where the product is eventually sold.

Furthermore, even though the bottlers presently operate within exclusive territories, the possibility is ever present that a bottler, despite his intrabrand monopoly, may be tempted for short-term profits or other reasons to cut corners by, for example, reducing the amount of syrup he mixes with carbonated water to produce the finished product, thereby reducing its quality. 35/ Recognizing this, respondents have provided the bottlers with the added business incentive not to produce substandard soft drinks. They have conditioned each bottler's right to continue to produce the trademarked product upon his faithful adherence to their quality standards. (Tr. 911-12). Thus a bottler's failure to meet respondents' standards of quality may result in the cancellation of his trademark license. (Tr. 778). At the manufacturing level, then, unscheduled plant inspections and frequent product sampling, coupled with the threat of termination, if not the act itself, should provide a strong deterrent to the bottler who might be inclined to cheat on quality, notwithstanding the markets in which he may ultimately distribute the finished products.

35/ Respondents' quality control inspectors also spot-check their bottlers by obtaining, for analysis, products which they purchase directly from retailers. (Tr. 921, 974-75). Because the bottlers presently need not identify themselves on their packages, successful spot checking now depends, in large measure, on the assumption, validated by respondents' territorial policies, that the soft drinks found on the retail shelves within a given territory were sold to the retailer by the bottler in that territory. To this extent, territorial restrictions facilitate product-source identification.

Yet the issue of whether territorial restrictions could ever be justified on the ground that they indirectly encourage quality control by assisting respondents' monitoring efforts need not be decided here. Rather, we find that respondent could as easily continue spot-check, quality control inspections at the retail level by requiring each bottler to place an identification mark on his product. Obviously, neither marking requirements nor territorial restrictions provide fool-proof safeguards against the production and distribution of defective products (RPF 125) or the "midnight" batch of substandard products which a bottler could presumably intentionally produce. A cheating bottler could be difficult to trace under either monitoring mechanism, yet a simple product-source identification mark (Tr. 804) like dating codes which bottlers may now employ (Tr. 1116-1119) would allow respondents to determine product origin as reliably as territorial restrictions. Further, if respondents employed a container dating which would be read without resort to a code, retailers and consumers would be able to monitor and detect the product's age.

2. In Distribution

Respondents further point out that their trademarks appear on the finished products which reach consumers, so their interest in maintaining product quality extends to the retail level. Respondents note that the bottlers assist in their overall quality control effort by offering stock rotation services to retailers and by removing the old product which may have deteriorated on the retail shelves.

The Commission recognizes the interest of a supplier in maintaining the quality of a trademarked product in the channels of distribution through which it travels to the marketplace. In Coors, we considered the needs of a brewer who sought to impose customer and territorial restrictions upon its distributors in order to ensure, among other things, that its beer remained refrigerated in storage and distribution from the brewery to the consumer. We pointed out, however, that a supplier of a trademarked product may have available to it means less anticompetitive than territorial or customer restrictions to ensure a reasonable measure of quality control at each level in the chain of distribution. Coors beer was brewed by a unique process and required continuous refrigeration. Thus our order in that case permitted the brewer to establish refrigeration standards not only for its own distributors, but downstream for the distributors' customers. The brewer was permitted to hold distributors responsible for inventory rotation by central warehouse customers and at the retail delivery locations where the beer was received from the central warehouse.

Having considered respondents' quality control objectives, we feel that the underlying rationale of our decision in Coors is clearly applicable. While the finished soft drinks need not be distributed through refrigerated channels, the shelf-life of these products is not indefinite; over time, the process of oxidation can sour the taste of these beverages. (Tr. 698, 978-79). 36/ Respondents may, however, establish reasonable

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36/ Estimates of this time span are variously given for bottled products as two to four weeks (Tr. 1116-17), three to eight weeks (Tr. 1240-41), 60 days (Tr. 1632), a few weeks (Tr. 979), a month or so (Tr. 2087), and several weeks for cans, if stored in a cool, dark place. (Tr. 1381). In addition, the shelf-life of canned products depends on whether the cans are made of steel or aluminum. Aluminum cans apparently retain taste quality a little longer than steel cans. (Tr. 1116-17, 1239, 1343-44, 2300).

quality control standards for distribution and storage, including inventory rotation policies, and may further require that each bottler identify itself on the bottle, bottle cap, or on the can so that respondents may reasonably monitor compliance with its quality standards. Clearly, quality control and intrabrand competition are not incompatible.

Under these circumstances, we are unable to conclude that territorial restrictions are reasonably necessary to ensure the taste uniformity or the purity of these products; quality control, trademark protection considerations do not, in this instance, justify the restraint imposed on the sale of the bottlers' finished soft drink products.

v. Interbrand Competition

Buttressed by the judge's finding that the "corridor area" exhibits "intense" interbrand soft drink price competition, respondents argue that their restraints on intrabrand competition are reasonable. The judge concluded that the prices which bottlers charge for Coca-Cola and allied products are determined by their costs and interbrand competition (IDF 106) and that bottlers cannot price Coca-Cola and allied products above the prices of other brands, such as Pepsi-Cola and 7-Up, without losing sales. (IDF 108-09). He also found that the bottlers of Coca-Cola frequently offer price promotions (IDF 127-30) and that a restriction on intrabrand competition is procompetitive because it allows the bottlers to focus on interbrand rivals, thereby increasing interbrand competition.

The record shows that Coca-Cola and the allied products compete with a wide variety of beverages. Evidence was adduced at the trial from which a list was compiled of the brand or trade names of products which, to one degree or another, compete with Coca-Cola; the list of brands is lengthy and will not be repeated here. (See RPF 157-80). In summary, it includes the names of hundreds of national, regional, and local flavored carbonated soft drink brands; private label soft drinks, the bulk of which are produced by contract canners for food chains and other types of chain stores; powdered mixes such as Kool Aid, Funny Face, and Wylers; and noncarbonated drinks, including such brands as Hawaiian Punch, Gatorade, and fruit juices and drinks. The Coca-Cola bottlers who testified in this proceeding agreed that all such products compete, at least to some degree, with Coca-Cola in bottles and cans. However, their testimony clearly demonstrates that flavored carbonated soft drinks generally and the brands, such as Pepsi-Cola, distributed by

other bottlers are the Coca-Cola bottlers' primary competitive rivals. As the record in its entirety amply demonstrates, the suppliers of these products exert the greatest influence on their competitive decisions. (See Tr. 1324-25; 1533; 3243). Consequently, we will focus mainly on the products which the bottlers have identified as their most important interbrand competition. Presumably, this is where the "intensity" of interbrand competition would be most evident.

A. Flavored Carbonated Soft Drink Brand Competition

The judge found that there is intense competition in the sale of flavored carbonated soft drinks "which stems from the fact that there is a large number of brands available to the consumer in local markets." (ID 36). As impressive as the number of brands on respondents' list may be, however, it is, in itself, no measure of the intensity of the competitive interaction among the brands or the bottlers or canners which supply them. Indeed, the judge's consideration of interbrand competition at the finished soft drink production and distribution level glosses over the customary practice of major brand bottlers to carry the brands of several different syrup companies, a practice which they refer to as "piggybacking." Nor does the initial decision reflect any analysis of the anticompetitive interbrand effects of geographic market restraints which admittedly permeate the entire industry. 37/ We believe that an accurate assessment of the condition of interbrand competition in this industry, that is, its "intensity" or "degree" as reflected in the record, must take these factors into consideration.

37/ The judge found that intense interbrand competition was evidenced by data showing a decline in Coca-Cola's food store market share during the period 1950 through 1971. In reaching this conclusion, the judge relied on two series of data stipulated by counsel and offered into evidence by respondents. In IDF 163, the judge found that Coca-Cola brand unit sales declined from 41.2 percent of total domestic flavored carbonated soft drink food store sales in 1950 to 24.4 percent in 1965. Unit sales, however, do not take into account the fact that soft drinks are packaged in containers of different sizes; it reflects only the number of bottles and cans sold, not liquid volume. (RX 2B). The record shows that prior to 1955, bottled Coca-Cola was available in only one size, the 6 1/2-oz. bottle. (RPF 253). In subsequent years, new sizes were introduced ranging from 6 1/2 ounces to 64 ounces. Yet on a unit basis, one 32-oz. bottle is the equivalent of one 6 1/2-oz. bottle, although it contains nearly five times as much beverage. Under these circumstances, the comparison of unit sales data before and after 1955 in IDF 163 is meaningless.

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1. Effect of Piggybacking on Interbrand Competition at the Bottling Level

Piggybacking involves the production and sale by a bottler of soft drink brands trademarked by two or more syrup companies. Each syrup company generally grants the bottler an exclusive territory for its brands. In piggybacking situations involving Coca-Cola bottlers, the territories are not always coextensive

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The judge also compared statistical case sales of Coca-Cola between 1960 and 1971 and noted that it declined from 22.3 percent of food store sales to 20.8 percent. (IDF 164). The statistical case represents a conversion of the sale of soft drink cases containing all package sizes to the equivalent of 24 8-oz. containers or 192 fluid ounces. As reflected in the stipulation, the "Coca-Cola" sales trend, on a statistical case basis, is as follows:

1955	20.0%
1960	22.3%
1965	19.5%
1970	21.1%
1971	20.8%

RX 2-Z44

However, the stipulation also shows that both total flavored carbonated soft drink food store sales and Coca-Cola brand food store sales increased rapidly during this period. Food store sales in 1955 exceeded 495 million cases. In the same year, Coca-Cola brand sales exceeded 98 million cases. By 1971 food store sales topped 1,573 million cases while Coca-Cola brand sales reached nearly 328 million cases. (RX 2-Z44).

Evidence of the meteoric rise in the volume of soft drinks sold during this period and Coca-Cola's relatively stable portion of this sizable volume, particularly since the early 1960s when diet soft drinks emerged as a strong factor in the market (Stipulation No. 3, CX 1244H-I), contradicts the contention that interbrand competition has significantly eroded Coca-Cola's position in the market.

In addition, we note that food store sales data relied upon by the judge fails to reflect Coca-Cola sales in a large number of non-food store outlets (RPF 221-22, RX 2Z41-42), and thus probably understates the brand's true strength. (See Tr. 2324). For this reason, the data cannot provide an accurate indication of either the Coca-Cola Company's soft drink syrup and concentrate sales to bottlers or the bottler's sales of finished, flavored carbonated soft drink sales in any local market. Moreover, even within the limited universe relied upon

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in size or dimension with their Coca-Cola territories, but they usually overlap to a substantial degree. 38/

The Coca-Cola Company argues that the brands piggybacked by its bottlers evidence interbrand competition. Some insight into respondents' rationale for concluding that competition is intense among a bottler's piggybacked brands was provided by the President of The Coca-Cola Company. According to Mr. Smith:

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in the initial decision, the fact is ignored that the Coca-Cola Company's allied product lines, including Tab, Sprite, Fresca and Mr. PiBB, which were introduced in the 1960s, had by 1971 captured about 4 percent more of total food store sales. (RPF 273). Had these brands been included, it is evident that the share of this universe attributable to the Coca-Cola Company's brands did not decline; rather it increased from about 20 percent in 1955 to about 24.8 percent of food store sales in 1971. Similar distortions are noted in the judge's analysis of the Pepsi-Cola brand's 1971 estimated market share of approximately 19.3 percent. This analysis also ignores "Pepsi" sales in non-food store outlets and PepsiCo's sale of such allied products as Diet Pepsi, Patio flavors, and Mountain Dew.

38/ Piggybacking is used extensively in the soft drink bottling industry. The record shows that in 1971, 438 of the 726 domestic Coca-Cola bottlers also distributed at least one soft drink brand not licensed by respondents. (Tr. 689). As a consequence, important national brand soft drinks, such as Dr. Pepper or 7-Up, are in some territories produced and sold exclusively by the local Coca-Cola bottler. Similarly, Nestea, canned ice tea, is sold under a territorial licensing system by 135 national brand bottlers, including 55-60 bottlers of Pepsi-Cola, 45-50 bottlers of 7-Up, and 30 bottlers of Coca-Cola. (RPF 262-63). In New York City, for example, where Coca-Cola is the leading flavored carbonated soft drink brand with a 14 percent market share in 1973, the Coca-Cola bottler sells several allied products and piggybacks both Welch's Sparkling Grape Soda and Dr. Pepper.

Other examples include the Reading Coca-Cola bottler who piggybacks Pennsylvania Dutch Birch Beer and Bottoms Up Chocolate (Tr. 1888-89); the Jamestown, N.D., Coca-Cola bottler who piggybacks 7-Up, Nesbitts Orange, Dads Root Beer, Squirt, and Sunrise Flavors (Tr. 1957); the Coatesville, Pa., Coca-Cola bottler who piggybacks Dr. Pepper and Pennsylvania Dutch Birch Beer (Tr. 2173); the Herminie, Pa., 7-Up bottler who piggybacks RC Cola; and the Dyersburg, Tn., Pepsi bottler who piggybacks Bubble-Up and Dr. Pepper. (*See* Tr. 961, 1443-45, 1600-01, 2809-10, 2863, 3005-07, 3063).

> [W]hen a product is put on the [retail] shelf the consumer is often unaware of its source...so what I am saying is when the consumer is shopping on a shelf or looking through a vending machine to pick a product, any product, (it) is in competition with any other product there in my opinion." (Tr. 781-82).

Were we to concern ourselves only with the image of competition which a lengthy recitation of brand names may project, the consumer's imperfect knowledge about who it is that actually supplies the brands might be superficially persuasive, and the effect of piggybacking might be safely ignored.

To the extent these brands represent the sale of syrups and concentrates by competing syrup companies, we acknowledge that they are a factor in the sale of soft drink ingredients to bottlers. (Tr. Oral Argument July 28, 1976 at 71-73). By contrast, however, in the sale of finished soft drink products to retailers, piggybacking allows a Coca-Cola bottler to control the pricing and marketing strategies for each piggybacked brand. (Tr. 1820-23). Thus he may determine unilaterally the extent to which pricing policies respecting one of these brands will be permitted to "cannibalize" sales of his other brands. (Tr. 2007-08). Consequently, if a competing bottler undercuts Coca-Cola and thereby cuts into Coca-Cola sales, the Coca-Cola bottler's only defense may be a responsive price cut. In contrast, if a Coca-Cola bottler who piggybacks Dr. Pepper finds that his price on a Dr. Pepper promotion is cutting too deeply into his Coca-Cola sales, he may find it in his interest to raise the price of Dr. Pepper rather than lower the price of Coca-Cola. (See Tr. 3037-38). Thus, the Coca-Cola bottler in New York City, having assessed the potential strength of Dr. Pepper in New York and having determined that its entry was imminent, became a Dr. Pepper "piggybacker" 39/ because: "we would rather compete with ourselves than have somebody else compete with us." (Tr. 2302).

39/ It is a policy of The Coca-Cola Company not to license its allied products to bottlers other than Coca-Cola bottlers. (Tr. 675). Consequently, bottlers have at times elected to piggyback certain brands or flavors of another syrup company, knowing that Coca-Cola allied products would not be introduced as competitive brands in their territory. Thus Mr. PiBB, respondent's Pepper-type drink, was not introduced in New York City because the Coca-Cola bottler there elected instead to distribute Dr. Pepper. (Tr. 2301). Had Dr. Pepper entered New York via

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Nor is it surprising that a bottler would prefer to shadowbox with "in-house" brands rather than meet the more rigorous competitive challenge of another bottler. In becoming "self-competitive," the bottlers' objective understandably is to "get more new sales volume from a competitor than from themselves." (Tr. 782, 2008). As a result, a Coca-Cola bottler who piggybacks Dr. Pepper, for example, will employ marketing strategies which are designed to take sales away from the brands of other bottlers without losing Coca-Cola volume in the process. (Tr. 1558, 2691). He may, for example, prevent price interaction among his piggybacked brands by selling each of his brands at the same price (Tr. 1822-23); by packaging one brand in returnable bottles and another brand in cans or nonreturnable bottles, thus minimizing head-on package competition between them; or by adopting other strategies depending upon the particular situation. (Id., Tr. 2392-93; See also Tr. 2553). While the record shows that bottlers are not always able, in the short run, to prevent one brand from cannibalizing the volume of another (See Tr. 2354-55), it also shows that the basic marketing strategy of brand proliferation is to increase the bottler's total sales in the long run or protect his other brands from erosion. (Tr. 2385-86, 3037-38, 2008, 2302). Notwithstanding respondents' vigorous protestations about the "intense" interbrand competition among a bottler's piggybacked brands, their bottlers understand that being self-competitive is not "the real thing."

Furthermore, evidence of the potential effect of piggybacking on the structure of the flavored carbonated soft drink bottling industry indicates that the practice tends to increase concentration. For example, in the territory of the San Antonio, Texas, Coca-Cola bottler, a large number of brands are available to the public. The bottler, when asked about interbrand competition, identified Pepsi-Cola, Diet Pepsi, and the allied products of PepsiCo.; Royal Crown and its allied products; Dr. Pepper, Diet Dr. Pepper, Canada Dry and its allied products; 7-Up; Shasta; Barqs; Nestea; Big Red; Orange Crush and its line of flavors called Matthews Dot; numerous flavor lines offered by other bottlers; and private label house brands of the major chains, such as Handy-Andy, among others.

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another bottler, such as the Pepsi bottler, the New York Coca-Cola bottler could have responded by introducing Mr. PiBB. Pursuant to The Coca-Cola Company's policy, however, the New York Coca-Cola bottler not only acquired control of the Dr. Pepper brand, it knew that no other bottler would have access to the competing Pepper-type drink, Mr. PiBB. Similarly, Coca-Cola bottlers who handle their own flavor lines understand that competing Fanta flavors will not be introduced in their territories by any other bottler. (See Tr. 1600-01, 1094-95, 1226, 1666).

The record also shows, however, that in San Antonio, Pepsi-Cola and its allied products and 7-Up and its allied products are manufactured and distributed by the same bottler who, in addition, offers his own line of flavors. (Tr. 2501). Another bottler manufactures and distributes RC Cola, Diet Rite Cola, and the Nehi Flavor line. (Tr. 2501-02). The Canada Dry bottler, in addition to Canada Dry and its line of ginger ale, sodas, and tonics, also manufactures and distributes Frosty Root Beer, Orange Crush, and the Matthews Dot flavors. (Tr. 2502). Big Red, which respondents cite as a strong regional competitor, is manufactured and distributed by the same bottler who manufactures and distributes Barqs flavors. (Tr. 2503-04). 40/

40/ Of all the flavored carbonated soft drink brands available in the food stores in San Antonio, Coca-Cola is the market leader. (RX2-Z37). The Coca-Cola bottler testified that his share of the flavored carbonated soft drink market sold through food stores in San Antonio varied anywhere from a low 34 percent to a high of about 40 percent (Tr. 2485-86, 2532-33) over a period of several years. (Tr. 2533-34). He further estimated that the Pepsi-Cola share varied from 17 percent to about 21 percent; Dr. Pepper from 8-11 percent; RC Cola from 6-8 percent; and Big Red, the strong regional brand, from 9-10 percent of the market.

Consequently, if the combined market of the San Antonio Coca-Cola bottler and the Pepsi-Cola bottler had fallen to their low points at the same time, these two bottlers still controlled 51 percent of the flavored carbonated soft drinks sold through food stores in San Antonio; and this would not reflect their sales through non-food store outlets. In fact, the Coca-Cola bottler alone placed about 8,000 vending machines throughout his territory. (Tr. 2481). Furthermore, according to the testimony of this defense witness, the four leading soft drink bottlers in his territory controlled about 68 percent of the total food store flavored carbonated soft drink sales, including the private label products sold by the chain stores. (Tr. 2533). Despite brand availability at the retail level, the evidence indicates that the San Antonio local bottling industry may be advancing toward fairly tight oligopoly.

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Evidence of this high level of concentration among the suppliers of the various piggybacked products strongly suggests that the "intensity" of interbrand competition cannot be realistically assessed simply by naming and counting brands available in a market. Indeed, we find much more significant the fact that piggybacking tends to increase the concentration of brands controlled by the strongest bottlers in a territory, while territorial restrictions shield them from the competition of extra-territorial interbrand bottlers.

B. Territorial Restrictions Lessen Interbrand Competition Among Soft Drink Suppliers

The judge also ignored evidence showing that territorial restrictions which prevent intrabrand competition also tend to lessen interbrand competition. (Tr. 960-61, 1879, 1900-1900A). Because the universe of potential customers available to a bottler is strictly limited by the boundaries of his territory 41/,

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Similarly, the record shows that in the Albany, N.Y., territory, Pepsi-Cola, according to the bottler called as witness by respondents, is the leading brand with a flavored carbonated soft drink brand market share of about 21-22 percent; Coca-Cola has about 16-17 percent. (Tr. 2935). Thus, these two brands alone account for about 37 percent of food store sales in Albany. In addition, however, the Pepsi-Cola bottler also controls Hires Root Beer; Orange Crush; Schwepp's carbonated soft drink line; canned Lipton Tea; and PepsiCo's allied products, including Mountain Dew. (Tr. 2863).

41/ In overruling *Schwinn*, the court in *GTE* made it clear that the degree of intrabrand competition foreclosed by a vertical restriction provided no basis for distinguishing situations in which the *Schwinn* per se rule would or would not be applied. *GTE*, *supra*, at 71,896. Under *GTE*, however, territorial restrictions must be evaluated by the traditional rule of reason framework of analysis to determine if they produce a demonstrable effect on competition. Thus the degree of foreclosure is a factor in assessing the overall competitive effect of the restraint. (*See generally* Elfman Motors, Inc. v. Chrysler Corp., 1977-2 Trade Cases, ¶61,650 at 72,683).

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he is prevented from competing against Pepsi-Cola bottlers and other soft drink suppliers interbrand for the business of retailers located within another Coca-Cola bottler's territory. (Tr. 887-88). Consequently, the restriction eliminates important potential interbrand price competition between a Coca-Cola bottler confined to a territory and virtually all interbrand suppliers serving customers in areas adjacent to his territories. 42/

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The Coca-Cola Company's territorial restriction is a demonstrably more severe restraint on intrabrand competition than the dealer location clause imposed by GTE. GTE designates the location of its retailer dealer's outlet, but apparently does not limit the area from which a retailer may draw its customers. The territorial restrictions involved here not only limit the area from which bottlers may solicit customers, they eliminate the retailer's option to do business with the Coca-Cola supplier offering the most competitive deals. Furthermore, as the restrictions are applied by respondents, they limit retailers in reselling the Coca-Cola and allied products; usually the product purchased from a bottler may be resold by a retailer only at outlets located within the territory of the bottler from which it was purchased. Thus, the vertical restraint in GTE's franchise does not constitute an exclusive territory (GTE at 71,893); nor does it ensure GTE's retailers freedom from intrabrand competition. Unlike the situation in GTE and Snap-On Tools Corp. v. F.T.C., 321 F.2d 825 (7th Cir. 1963), in which customers were free to buy in any territory from any dealer, thus leaving open the potential for intrabrand competition among the dealers, respondents' practice mandates exclusive territories and completely eliminates intrabrand competition among the bottlers of Coca-Cola and allied products.

42/ This is illustrated by pricing data relied upon by respondents. The record shows, for example, that cases of 24 12-ounce cans of both Coca-Cola and Pepsi-Cola have been offered at wholesale for $3 in Baltimore. At the same time, a case of Coca-Cola in 12-ounce cans was offered to retailers for $2.90 by a different bottler serving Havre de Grace, Maryland. Yet the Coca-Cola bottler who served Havre de Grace through a distribution center was prevented by the territorial restriction from offering or selling canned or bottled Coca-Cola to retailers in the Baltimore territory, thirty miles away (Tr. 2960), in competition with the Baltimore Coca-Cola bottler, intrabrand, and the Baltimore Pepsi bottler, interbrand. (See RPF 192, Tr. 1564).

1. Territorial Restrictions Industrywide Lessen Interbrand Competition

When this effect is considered in light of the fact that respondents' territorial restrictions are nationwide in scope, and in light of the further fact that territorial restrictions are an industrywide practice restricting "Pepsi" bottlers and the bottlers of numerous other major and secondary brands throughout the country (RPF 17), it is difficult to avoid concluding that territorial restrictions, vertically imposed, have seriously impaired interbrand competition. Not only are Pepsi-Cola bottlers and other soft drink suppliers shielded by respondents' restriction from the competition of all but one Coca-Cola bottler for the business of virtually any given retail outlet, the industrywide nature of the restraint insulates Coca-Cola bottlers from unimpeded competition of potential interbrand bottlers.

Evidence of this insulating effect is reflected in the pricing behavior of respondents' bottlers in territorial overlap situations. Overlaps occur when, for example, the territory of a Coca-Cola bottler encompasses all or a part of the territories of two or more bottlers of a competing brand, such as "Pepsi." Like the Coca-Cola bottlers, "Pepsi" bottlers are also confined by territorial restrictions which prevent them from competing with each other. In these situations, the Coca-Cola bottler will, in any given segment of this territory, compete with only one of the Pepsi bottlers. For example, the record shows that Warrenton, Virginia, is outside the territory of the Washington, D.C., Pepsi bottler, but within the territory of the Washington Coke bottler. Because the Warrenton Pepsi-Cola bottler has at times charged lower prices than the large Pepsi bottler in the metropolitan Washington area, the Coca-Cola bottler has been forced to respond with lower prices in that part of its territory. As Mr. Wilbert N. Sales, Vice President and General Manager of Washington Coca-Cola Bottling Co., Inc., testified:

A. ... Warrenton is priced well below Alexandria, and the reason for that is competition.

Q. Could you explain what you mean by that?

A. Well, basically in that market it is Pepsi-Cola. Pepsi-Cola out of Charlottesville, Va. They are priced way down.... This is the way he operates, and he couldn't care less whether he makes money or not, so there is the problem. (Tr. 1259).

In respondents' view, the fact that the Washington Coca-Cola bottler charges lower prices in overlap areas to meet competition from Pepsi bottlers, other than its major Pepsi bottler competitor in the Washington, D.C., metropolitan area, is evidence of interbrand price competition rather than the lack of it. (Ans. Br. 88). This is correct to the extent that interbrand competition exists in both instances, but it can also be reasonably inferred from this evidence that interbrand competition between Coca-Cola and Pepsi-Cola may be significantly less "intense" in the Washington metropolitan area than it is in the Warrenton area. Moreover, the Pepsi bottler serving Warrenton is, as a result of the territorial restrictions imposed by PepsiCo, precluded from expanding into Northern Virginia and perhaps Washington whenever higher "Coke" or "Pepsi" prices prevail in these areas. 43/ Consequently, retailers and consumers in a major metropolitan market are deprived of the benefits of an open market in which the Washington Coke bottler probably would have had to meet the interbrand competition of the Warrenton Pepsi supplier in a wider geographic area and, at the very least, would have had to consider this bottler a serious potential interbrand price competitor outside of the Warrenton area, a consideration which Washington metropolitan bottlers may completely disregard. (Tr. 1314).

What has occurred between the Warrenton Pepsi bottler and the Washington Coca-Cola bottler is not simply an isolated episode without broader competitive significance. The situation in Warrenton illustrates a fundamental limitation on interbrand price competition in the soft drink bottling industry not only in overlap situations, but as a direct result of territorial restrictions nationwide. Recognizing this, respondents contend that disparities in the wholesale list prices of bottlers in different territories have no probative value because bottlers use alternative pricing strategies; some bottlers offer lower list prices, other bottlers adopt higher list prices but engage in more frequent promotions. (Ans. Br. 75, 88). 44/

43/ Conversely, the restriction would allow the Charlottesville Pepsi Bottler to raise his prices in the portions of his territory located outside of the Warrenton area without regard for a lower price which the Washington Coca-Cola bottler may be charging at the time. (Tr. 1259-60).

44/ Obviously, a wholesale price considered "low" by one bottler may be considered high by another bottler. Similarly, what one bottler considers "frequent" promotions may be considered occasional by another, just as a "deep" price promotion in one territory may be considered miserly in another.

The fact that different bottlers use different pricing strategies and price levels at wholesale and during promotions in different territories is, itself, a strong argument for lifting the restriction in order to allow the various prices and pricing strategies to clash head-on in the marketplace. We regard the uncertainties created by the confrontation of pricing strategies as the very essence of competition which the present system of territorial restrictions, to a large extent, eliminates. Whether a Coca-Cola bottler's pricing strategy is to compete on the basis of wholesale list prices or price promotions, or both, the fact remains that territorial restrictions rule him out as an actual or potential competitive rival of all soft drink suppliers, intrabrand and interbrand, in every locale beyond the territory assigned to him by respondents. In view of the fact that respondents' bottlers and virtually all other major brand bottlers are similarly restricted, we conclude that the practice is, to a substantial degree, adversely affecting interbrand competition at the bottling level of this industry. 45/

45/ Respondents contend that territorial restrictions promote competition at the syrup-producing level because they make possible a means for the lesser-known brands of their syrup company competitors to enter easily into new local markets. (Ans. Br. at 91, IDF 159-162, RPF 262-64). As we have previously noted, Coca-Cola bottlers and other major brand bottlers piggyback the "lesser" brands of other syrup producers within exclusive territories granted to them by those producers. To this extent both piggybacking and exclusive territories may assist the company's entry into the soft drink syrup production industry. However, we are not here dealing with the reasonableness of territorial exclusivity conferred by a small syrup producer of one of the "lesser" brands.

Respondents argue further that removal of territorial restrictions on the sale of Coca-Cola and the allied products will generate competitive forces which will result in the demise of many Coca-Cola bottlers and the secondary brands which they piggyback into local markets. (Respondents' "small bottler" arguments are considered, in detail, infra). While the record shows that the number of independent Coca-Cola bottlers has, notwithstanding respondents' territorial restrictions, declined significantly since 1968, the record does not indicate the fate, in local markets, of the secondary brands formerly piggybacked by bottlers who have sold their businesses to neighboring bottlers or have consolidated their territories or bottling plants. (See Text at 66, fn. 63 infra). Presumably the secondary brand syrup producers were free to franchise either the bottler which took up the distribution of Coca-Cola within the territory from which its predecessor withdrew or any other independent bottler

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Thus we find reflected in the testimony of virtually every bottler who testified at the hearing and the top management of The Coca-Cola Company the fear that intrabrand competition would, in fact, cause prices to fall. The President of The Coca-Cola Company testified that absent territorial restrictions, there would be price competition at the wholesale level which does not exist under the territorial system. (Tr. 739). 46/ In the opinion of another experienced executive of The Coca-Cola Company:

> I think under this "walls down" thing.... No territorial exclusivity, no territorial restrictions, that Coca-Cola and our other products, or products from other bottlers would find its way into chain stores warehouses.
>
> I think ... that pricing would be more active than it ever had been. [I] think that it would mean that ... to be competitive, and to get the business, we would have to make up our minds either we want the business or don't want it. We would be forced to reduce our prices to the principal customers. (Tr. 992-93).

This assessment, by key management personnel of The Coca-Cola Company, was echoed by bottlers who predicted wholesale price reductions if the restrictions were lifted. (Tr. 1568, 2459, 2855). Yet it would not, as the record shows, just be the price of Coca-Cola which would be more active as a result of intrabrand competition; the suppliers of hundreds of other interbrand soft drink products must be responsive to the prices of Coca-Cola and the allied products and they could not afford to ignore for too long any reductions in the wholesale price of these products.

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distributing other brands in the local territory or neighboring territories. (See Tr. 1672, 1684, 1668). Thus The Coca-Cola Company argued in Sulmeyer v. Coca-Cola, supra, in defense of a complaint alleging that it was monopolizing the business of the independent Coca-Cola bottlers which it secured for the distribution of its lemon-lime flavored product, Sprite, that the universe of independent bottlers capable of effectively bottling and distributing the lesser-known brands was not limited to those bottlers who market Coca-Cola. After reviewing the evidence adduced at the trial, the Fifth Circuit Court of Appeals agreed with respondents, noting that a secondary brand "could reach the consumers in a given area through a franchise agreement with any independent bottler." (at 850). We are, therefore, unable to accept respondents' contention that the territorial restrictions which they impose on the sale of Coca-Cola and allied products are necessary to ensure the competitive viability of syrup companies which compete with respondents.

46/ See IDF 171.

2. <u>Intrabrand Competition in the Sale of Coca-Cola and the Allied Products Would be Likely to Result in Increased Competition in the Sale of Soft Drink Beverages</u>

Respondents argue that Coca-Cola and the allied products are sensitive to the prices of competing brands, and as a result, the bottlers' pricing decisions must be influenced by the interbrand competition in their respective territories. As respondents submit, there is evidence of price sensitivity in the record; however, as we have determined, the "intensity" of interbrand competition in the soft drink bottling industry is affected by piggybacking and substantially diminished by the territorial restrictions imposed by respondents and similar restraints imposed industrywide by other syrup companies. As a result, interbrand competition may not be fully exploiting the price sensitivity of respondents' soft drinks, and equally important, as a consequence of the restraints on intrabrand competition here challenged, Coca-Cola and the allied products are not fully challenging the sensitivity of other soft drink products to their prices.

Evidence adduced at the trial by respondents shows that Coca-Cola and the allied products compete with such products as local, regional, and national brand flavored carbonated beverages; private label soft drinks; and to some extent, powdered mixes and noncarbonated drinks. (RPF 157-80). To the extent Coca-Cola competes with and is price sensitive to these types of products, it may be concluded, particularly in view of the fact that Coca-Cola is the nation's leading flavored carbonated soft drink premium brand and a dominant brand in many local markets across the country, that other soft drink products are equally, if not more, sensitive to Coke prices. According to the bottlers of other brands, price competition of Coca-Cola takes sales away from Pepsi-Cola (Tr. 2886-87, 2889-90), 7-Up (Tr. 2682), Nestea (Tr. 3456), and Lipton canned ice tea (Tr. 3562-63). (RPF 219). Mr. Hurst, the marketing manager for Nestea Co., testified that his canned ice tea product loses sales if it is one cent higher per six-pack than the premium priced carbonated soft drinks such as Coca-Cola. (Tr. 3456-57). Similarly, in response to questions propounded by respondents' counsel, the defense witness, who bottles Pepsi-Cola, Dr. Pepper, and Bubble-Up in Dyersburg, Tennessee, testified:

> Q. Can you afford to sell Dr. Pepper at a higher price than Coca-Cola is being sold in your territory?
>
> A. Oh, definitely not.
>
> Q. Now, are we talking about a dollar more, or a few cents per case?

A. I don't think--well, we would not let ourselves be caught in a situation whereby, over an extended period of time, any major product was being sold at a cheaper price than our products.

Q. You mean when you say cheaper....

A. Not even one or two or three cents a bottle or carton. (Tr. 3046).

While respondents, in their answer brief, attempt to minimize the importance of intrabrand competition among the bottlers of Coca-Cola, the acknowledged sensitivity of interbrand soft drink products to the price of Coca-Cola and the allied products refutes respondents' contentions. Because Coca-Cola is, as respondents' evidence solidly confirms, an important interbrand competitive force in the market, a practice which eliminates intrabrand price competition has adverse repercussions throughout the entire soft drink industry. As the evidence clearly demonstrates, lower prices for Coca-Cola would, in turn, exert enormous downward pressure on the price of interbrand flavored carbonated beverages and, to a lesser degree, on Kool Aid, Funny Face, fruit juices, and all other soft drink products which, according to the bottlers, compete with Coca-Cola.

For this reason, the judge's conclusion that competition among the independent bottlers of a premium brand soft drink such as Coca-Cola would "dilute" their competitive efforts against interbrand bottlers could not, consistent with the pricing dynamics of this industry, apply to pricing behavior. Rather than dilute the Coca-Cola bottlers' competitive impact interbrand, the record shows that intrabrand price competition would, perforce, strengthen their impact considerably. Thus it does not appear that price competition in this industry is enhanced by respondents' territorial monopolies. In fact, evidence in the record demonstrates that exactly the opposite is true. We conclude that respondents' territorial restrictions substantially lessen competition among soft drink suppliers in the "corridor area" and the rest of the country, in violation of Section 5 of the Federal Trade Commission Act. 47/

47/ Respondents and intervenors contend that the legality of their territorial licenses was judicially upheld in 1920 in The Coca-Cola Bottling Co. v. The Coca-Cola Co., *supra*. In ruling on the legality of the territorial licenses in response to the actions The Coca-Cola Company had taken to put its bottlers out of business, however, the district court was not required to decide,

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VI. Relief

A. Returnable, Refillable Packaging

Respondents' bottlers package their products in two basic types of containers: those which the consumers usually discard after use and those which may be returned to the bottler, purified, and reused. Both types of containers offer consumers distinct advantages. Nonrefillable cans and bottles, or nonreturnables as they have been referred to in this proceeding, appeal to consumers who prefer convenience, throw-away packaging and are willing to pay for it. Refillable bottles, in contrast, appeal to consumers who are concerned more with economy than

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nor did it have before it, the legality of the territorial restrictions which are now before us. The basic question before the court there was whether The Coca-Cola Company had the right arbitrarily to terminate the bottlers over disputes concerning the price of syrup. The consent decree eventually entered in that case reflected, in part, the court's ruling that the bottlers have a right to purchase Coca-Cola syrup and to use the trademark, in perpetuity, and to be free, not from the threat of competition among themselves, but from arbitrary termination by The Coca-Cola Company. The regulation of competition among the independent bottlers was not an issue joined before the court; the provisions of the consent decree respondents rely upon in support of the restrictions here challenged apparently were inserted by the parties to accommodate their private interests.

More directly on point is the decision of the district court in Tomac, Inc. v. Coca-Cola Co., 1976-2 Trade Cases, ¶60,988, in which the court, in a private treble damage action, overturned a jury verdict finding respondents' territorial restrictions illegal. The judge in Tomac concluded that the restraint was reasonable because it promoted a legitimate business purpose by providing incentives for capital investment and enhancing competition. (at 69,381). For reasons discussed at length in this opinion, we respectfully reach a contrary conclusion. We feel it is, in these circumstances, appropriate also to note that decisions of federal and state courts approving a practice challenged by the Commission would not foreclose a contrary FTC Section 5 decision, nor would consent decrees entered by agreement of the parties in settlement of a private suit. FTC v. Sperry & Hutchinson, 405 U.S. 233, 239 fn. 4 (1972).

convenience. 48/ For reasons stated below, we find it unnecessary to disturb established bottling territorial relationships which now exist with respect to the sale of Coca-Cola and allied products in returnable, refillable bottles. As in litigation involving mergers which violate Section 7 of the Clayton Act in which partial rather than full divestiture provides satisfactory relief, Federal Trade Commission v. PepsiCo, Inc., 477 F.2d 24, 29-30 (2d Cir. 1973); U.S. v. Reed Roller Bit Co., 274 F. Supp. 573 (W.D. Okla. 1967); Warner-Lambert Co., 87 F.T.C. 889-90, 88 F.T.C. 503 (1976); RSR Corp., 88 F.T.C. 873, 892-97, we have here determined that partial relief, which is limited to lifting the restrictions as they apply to nonrefillable containers, is fully adequate in the interest of maximizing both intra-brand and interbrand competition.

48/ As we mentioned earlier, prior to 1955, the only unit in which bottled Coca-Cola was offered was the 6 1/2-ounce returnable container. (Unless otherwise indicated, the term "returnable bottle" or "returnables" refers to the type of bottle which can be refilled and reused by the bottler.) The popularity of returnables declined after disposable containers were introduced, then increased and stabilized. This recent stabilization is attributed principally to adjustments in the deposit structure and the fact that economy-minded purchasers are buying refillable bottles and returning them while convenience buyers are purchasing nonrefillable packages. (RPF 349).

Today the refillables are an important competitive factor in the market, accounting for about 55 percent of the sales of Coca-Cola in bottles and cans on a volume basis. (RPF 348, Tr. 3633).

From territory to territory, the percentage of soft drinks sold in refillable bottles varies. (Tr. 3758-59, 3777-78; RX 7). For example, 30 percent of the sales of Coca-Cola in bottles and cans in Washington, D.C., are packaged in refillable bottles (Tr. 1167); 65 percent in Hartwell, Georgia (Tr. 1384); 70 percent in Spirit Lake, Iowa (Tr. 1462) and the State of Iowa generally (Tr. 1463); 30 percent in Wilmington, Delaware (Tr. 1541-42); 25 percent in Havre de Grace, Maryland (Tr. 1542); 75 percent in Charleston, West Virginia (Tr. 1542); 54 percent in Miami (Tr. 1542); 74 percent in Montross, Virginia (Tr. 1633); 40 percent in Reading, Pennsylvania (Tr. 1916); 20 percent in Coatesville, Pennsylvania (Tr. 2172); 51 percent in San Antonio (Tr. 2487); 45 percent in Stockton, California (Tr. 2567); 55-57 percent in Palo Alto, Burlingame, and San Mateo, California (Tr. 2610); 60 percent in Jamestown, North Dakota (Tr. 1982); and 70 percent in Ada, Oklahoma (Tr. 2670). (See also, Text at 17 supra).

We have carefully considered complaint counsel's suggested option of placing an identification mark on each bottler as a method of preserving the competitive viability of the refillable bottle, but we are unable, on the basis of the record evidence, to agree with their contention that less restrictive measures are viable alternatives in the context of a system in which refillable bottles are purchased and used by numerous independent producers of a nationally trademarked finished soft drink which is also offered in nonrefillable bottles and cans.

1. Economy of Returnable Bottles

It is uncontroverted in the record that in virtually every territory in which refillable and nonreusable packages are offered, Coca-Cola is, on a per-ounce basis, significantly cheaper in the refillables 49/, and the advantage is evident notwithstanding the fact that these bottles initially cost the bottler more than cans and disposable bottles, and the further fact that retailers generally take a larger markup on returnable bottles to compensate for the additional cost of handling the empties returned by consumers. (RPF 132).

49/ Evidence of the economy of the returnable bottle is reflected in the per-ounce price differentials between Coca-Cola in returnable bottles and nonreturnable containers. For example, in July, 1971, it cost the consumer in Baltimore approximately 33 percent more per ounce to buy Coca-Cola in 16-ounce nonreturnable bottles than in 16-ounce returnable bottles, and 66 percent more per ounce in 12-ounce cans than in 16-ounce returnable bottles. (Tr. 982). In Wilmington, Delaware, the retail price of 32-ounce returnable bottles of Coca-Cola is four for $1.69 or 1.32 cents per ounce; the prevailing retail price for cans is six for $1.49 or 2.06 cents per ounce, 36 percent more expensive to the consumer on a per-ounce basis. (Tr. 1541). In Montross, Virginia, the 16-ounce returnable bottle retails in supermarkets at 1.08 cents per ounce (Tr. 1680); cans retail at 2 cents per ounce or approximately twice as much. (Tr. 1680, 1692). In Jamestown, North Dakota, the current retail price per ounce of Coca-Cola in 32-ounce returnable bottles is 1.2 cents; the price per ounce in 32-ounce nonreturnables is 1.5 cents and in cans, 2.2 cents. (Tr. 1981). Coca-Cola in 16-ounce returnable bottles is, on a per-ounce basis, 29 percent cheaper than Coca-Cola in 16-ounce nonreturnables; 27 percent cheaper than Coca-Cola in 32-ounce nonreturnables; 16 percent cheaper than Coca-Cola in 64-ounce nonreturnables; and 61 percent cheaper than Coca-Cola in 12-ounce cans in Reading, Pennsylvania. (Tr. 1925). In San Antonio, Texas, the prevailing retail price per ounce for Coca-Cola in 16-ounce and 32-ounce returnable bottles is about a penny. Coca-Cola in 48-and 64-ounce nonreturnable bottles retails at about 1.5 cents per ounce, or 50 percent more expensive, and Coca-Cola in cans retails at 1.9 cents per ounce, or 90 percent more expensive. (Tr. 2488, 2551; RPF 208).

2. Bottle Trippage

The record shows that in pricing his packages, a bottler must be able to anticipate, with a reasonable degree of accuracy, his returnable bottle requirements and glass "float" inventories. 52/ (Tr. 700, 735, 2486; RPF 131). While bottlers continuously invest in returnable bottles to replace those which are lost or no longer usable (RPF 69), the territorial restrictions permit the bottler to anticipate that most of the reusable bottles he puts into the market will be returned by the consumers to the stores within his territory and will be returned by those stores to him. As a result, a trippage rate, which represents the average number of cycles or reuses a bottler can expect from a bottle, can be determined in each territory (Tr. 3635) 53/, and used by the bottler in allocating container costs in accordance with his anticipated trippage experience. Generally, the lower the trippage rate in a territory, the more rapidly the bottler must recoup the bottle's full cost, thus increasing the per-ounce price of the soft drink. 54/

52/ The term "float" refers to the total number of refillable bottles of a given type in the bottler's system; it includes those in the inventories of both the bottler and the retailers in his territory as well as those in the homes of consumers. (Tr. 3769). A bottler's minimum "float size" equals his sales multiplied by his anticipated turn-around period. Thus, if the bottler's turn-around time is six weeks and on the average he sells 100 24-bottle cases of returnables per day, five days a week, his float size would be approximately 3000 cases or 72,000 bottles [100 (cases) X 24 (bottles per case) X 5 (days) X 6 (weeks turn-around time).]. (Tr. 3770).

53/ The trippage rate, in turn, depends upon a bottler's "float" size and estimated turn-around time (or the anticipated time it takes each bottler on an average to recover an empty from the consumers in his territory) and the bottler's loss rate. Thus, in a territory in which sales remain constant, "float" size is constant, and turn-around time is constant, the replacement rate would be equivalent to the loss rate, and the bottler would purchase just enough bottles to replace those which have been lost or destroyed. In contrast, in territories in which sales are increasing, the bottler must not only replenish the bottles he has lost, but also invest in a bigger "float;" if sales are decreasing, on the other hand, the bottler's "float" itself may supply his bottle needs so no new investments in glass may be required. (Tr. 3636).

54/ In territories in which returnable bottles are offered, the record shows that trippage rates vary from as low as five in some territories to as high as 30 in others. (Tr. 2579, 2995, 1859; RPF 344).

The price disparities reflected in this record are, to a large extent, explained by the fact that when a consumer buys soft drinks in nonreturnable bottles and cans, the bottler, at wholesale, and the retailer must recover the full cost of each beverage container with each sale. 50/ In contrast, the full cost of a refillable bottle ordinarily need not be recouped all at once, but can be spread over the number of trips the bottler can expect the bottle to make before it is lost, destroyed, or no longer usable. (Tr. 997). 51/ Consequently, if a 16-ounce returnable bottle which costs 12 cents survives 18-20 trips, it generates a container cost of only a fraction of a cent per trip. (Tr. 1461-62, 2488, 3996). As one bottler testified:

> ... when I price my packages I add right on top, the cost of the package. A 10-ounce package, for instance, of a returnable Coke is $2.50 a case ... 240 ounces, so we are talking about 1.1 something (cents per ounce).
>
> When we talk about a 10-ounce NR (nonreturnable) package, we are talking about $3.60 a case for 240 ounces, probably 1.5 (cents) per ounce, so that is the price of convenience. (Tr. 2149, RPF 209).

50/ The record shows that a case of 24 12-ounce aluminum or steel cans costs about $1.44 or 6 cents per can. The Coca-Cola bottler in Spirit Lake, Iowa, for example, testified that Coca-Cola in his territory in 16- and 32-ounce returnable bottles is about 50 percent cheaper than Coca-Cola in cans, even though a case of 24 empty 12-ounce cans costs him $1.44 while a case of 12 empty 32-ounce returnable bottles costs him about $3.11. Yet because his trippage rate is about 25 per bottle, his container cost per case for 32-ounce returnables (i.e., 384 ounces) is about 11 cents per trip, in contrast with the full $1.44 per case (i.e., 288 ounces) on one-way bottles or cans. (Tr. 1462).

51/ The nonrefillable bottle is not designed to withstand the punishment of reuse. Made of thinner glass than the refillables, products liability considerations dictate that it be used only as a one-way, one-fill container. (Tr. 3765-68). While some jurisdictions have enacted litter laws which require the consumer to pay a deposit, which is refundable upon the return of nonrefillable bottles and cans, the containers reclaimed are not returned to the bottler for reuse. Instead, the nonrefillable bottles recovered from post-consumer waste streams are processed or recycled into crushed glass or cullet for glass-making processes. Unlike the refillables, then, the bottler cannot spread the cost of a returnable, nonrefillable bottle or can over more than one sale.

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3. Bottle Recapture

In assessing the impact of the order proposed by complaint counsel, it is pertinent in the context of respondents' bottler network that the use of refillable bottles makes economic and competitive sense only if each bottler is able steadily to recapture from the market an adequate, predictable supply of used bottles to service his production requirements. Consequently, there are two major impediments to intrabrand competition in the use of refillables: First, retailers will, from time to time, switch their Coca-Cola bottler supplier; and second, consumers will buy and return bottles to different retailers. Over an indefinite time, then, the refillable bottles provided by a number of bottlers will periodically be returned by consumers either to the store from which they were originally purchased or to a different store supplied by the same or different bottlers. As a result, bottle recapture, under these circumstances, would be unpredictable and economically burdensome. (Tr. 2996-98, 2027). Even if the bottler were to place an identification mark on his bottle, it would be impractical and costly to expect the retailer to notify each bottler whose bottles he may have collected or to require the bottler to divert his trucks to pick up a few empty bottles from retailers who, at the time, may be purchasing "Coca-Cola" from a competing bottler. (Tr. 2544-49).

Nor would the burden of recapture be substantially reduced if a bottler picked up all of the empties, regardless of their source, from each of his customers. Each bottler individually purchases his returnable bottle float and must be able to anticipate his bottle needs based on trippage experience in his territory. Retail outlets which collect large numbers of returnable bottles would provide an abundance of bottles to their suppliers, while other bottlers serving retailers which collect relatively few bottles may experience shortages. Because a bottler would be unable to predict the retail customers he may acquire or lose over time, or their locations, and because bottlers maintain glass inventories of varying sizes, there can be no assurance that the number of bottles a bottler puts on the market will, on a random basis, equal or even closely approximate the number he may pick up in return. It would be virtually impossible for a bottler to determine, with a reasonable degree of accuracy, what portion of his float outstanding in the market will be returned to him for reuse.

Alternatively, if each bottle carried an identification mark and all bottlers picked up all empties from their respective customers, each bottler would be picking up other bottlers' bottles, backhauling the empties, storing them, and notifying the other bottlers who would have to pick them up from widely dispersed collecting bottlers, thus substantially increasing the handling costs associated with the use of returnables while diminishing their economy advantage. It has been stipulated on this record that the use of returnable bottles is incompatible with central warehouse distribution by retailers largely due to the impracticality and costs of having the retailer collect, backhaul, sort, and store empty bottles for the bottlers. Nothing in this record suggests that it would be any more practical or much less costly for a bottler to perform a central warehouse function for the return of other bottlers' empty bottles.

Similarly, a credit system which would permit a bottler to use bottles purchased by competitors would probably not result in a competitively viable distribution of empties in accordance with the bottlers' bottle needs or investments. Bottlers may offer a wide range of refillable options, including 6 1/2-ounce, 10-ounce, 16-ounce, 26-ounce, and 32-ounce sizes with different investments in each size; and while some bottlers offer most sizes, other bottlers offer only one or two. Consequently, a bottler who maintains a sizable float which presently services his production runs may end up, from week to week, with too few bottles actually on hand against which credits could be claimed to compete effectively for returnable bottle sales. This could occur, for example, either because a bottler may, as we mentioned, lose retail accounts which collect large numbers of empties or because he may be collecting an assortment of bottle sizes, some of which may not be compatible with his bottling line equipment, or because he has collected too few bottles in each size to offer any size on a competitive basis. 55/

While an increase in the amount of the deposit a bottler may require might protect his investment in glass bottles (Tr. 2097, 3098-3100), the competitive potential of the returnable bottle system would likely be lessened since higher deposits would probably meet with appreciable consumer resistance and encourage a shift to disposables. (Tr. 3051, 2522, 996, 2871, 1994). Nor would intrabrand competition be

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55/ Even if several bottlers were to form a cooperative for the production of soft drinks in refillable bottles, the recapture problem would still exist vis-a-vis the members and nonmembers of the co-op. (*See* Tr. 2139-41).

fostered if bottlers had to invest continuously in new bottles or even used bottles, assuming a secondary used bottle market were to spring into existence, to compensate for wild, frequent fluctuations in float. (Tr. 998).

Under these circumstances, we find it unnecessary to lift restrictions on the sale of Coca-Cola and allied products in refillable bottles.

Rather, as the record shows, fully adequate relief in this matter necessitates only the lifting of the restriction as it affects the sale of these products in the nonrefillable containers. Because the relative market strength of convenience and returnable, refillable packaging is largely dictated by a price spread sufficient to maintain the consumers' participation in the return system, any downward price movement resulting from intrabrand competition in the sale of nonrefillables would directly influence the price of refillables. Conversely, a viable refillable bottle system operating in the context of an exclusive territory will provide each bottler with a potent price-competitive package. The relief entered in this proceeding will, therefore, differentiate between reusable and nonreusable bottles and cans based upon demonstrated economic effect. (GTE, supra).

4. Split Delivery

We are mindful of respondents' defensive arguments that the use of refillable bottles is inexorably linked to territorial exclusivity and store-door delivery of each bottler's entire package mix, and the belief expressed by several bottlers that chain store outlets would substantially reduce, if not eliminate, their refillable bottle purchases if warehouse delivery of other types of packages were offered to them. Respondents' scenario projects a decline in the volume of soft drinks packaged in refillable bottles and distributed via store-door delivery and, as a result, price increases to cover fixed costs at the reduced volume. (Ans. Br. at p. 57).

While the record shows that a few high-volume chain stores have refused to retail returnable bottles (Tr. 2170-72, RPF 135-46) 56/, we find no basis in the record for concluding that a

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56/ The record shows, for example, that in Coatesville, Pennsylvania, several food chains have declined to handle returnable bottles (RPF 143), but the bottler in that territory not only offers returnable bottles, he offers his 10-ounce returnable bottles of Coca-Cola for $1.10 less per case than his 10-ounce nonreturnables (RPF 209, Tr. 2149); and

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substantial segment of the nation's chain store population will follow this lead. According to the bottlers, some chain store customers complain about the handling costs associated with storing and sorting empty bottles (RPF 136), but respondents submit that the retailers take a markup sufficient to compensate them for their trouble, and there is no indication that the profit on returnables is not comparable to that which is made on nonreturnable bottles and cans. (RPF 132, 137). Apparently, the refusal to retail this package is a competitive decision, and in view of the uncontroverted evidence that the wholesale price for returnable, refillable bottles is usually cheaper than nonrefillables, the retailer who rejects the former may be less price competitive as a consequence. (Tr. 1771-73). Although some retailers may justify the disadvantage, many more likely will not.

As the record shows, demand for returnables has increased and stabilized in recent years at about 55 percent of "Coca-Cola's" nationwide can and bottle statistical sales volume 57/, and while the percentage varies from territory to territory, returnables are a significant factor in virtually every territory surveyed in this record. (RPF 348). We therefore find it difficult to conclude that most high-or low-volume soft drink retailers who now handle the package would ignore this demand by declining to offer consumers the choice between convenience and economy packaging.

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despite the refusal of the chain stores to retail this type of package, he is planning to introduce the 32-ounce returnable, resealable bottle. (Tr. 2171). Similarly, in Reading, Pennsylvania, four large chain stores do not carry returnables, yet 16-ounce returnable bottles, priced on a per-ounce basis, were 61 percent cheaper in that territory than Coca-Cola in 12-ounce cans. (RPF 208). In Albany, New York, no chains carry Coca-Cola in returnable bottles, but the package is available in that territory. (RPF 143).

57/ According to stipulated data, total food store sales of the Coca-Cola brand alone in 1960 represented the movement of 143 million statistical cases, including returnable bottles and nonreturnable bottles and cans. (RX 2Z-44). By 1971 these statistical case sales of Coca-Cola had grown to 327.9 million cases. If we assume that only half of the Coca-Cola food store sales volume in 1971 were sales in returnable bottles (Tr. 661, 777-78, 3633, 3653, 3755), Coca-Cola brand volume in returnable bottles alone was a little over 163.9 million statistical cases, exceeding by approximately 20 million statistical cases the returnable and nonreturnable food store package volume in 1960. (Tr. 3653).

Furthermore, while numerous bottlers subscribe to the contention and therefore conclude that returnable bottles could not be offered competitively in a split-delivery environment of store-door distribution and central warehousing, their testimony is largely based on speculation. (Compare Tr. 3575-76). Only two of the Coca-Cola bottlers who testified in this proceeding ever experimented with split-delivery of Coca-Cola, and their testimony shows that chain stores which have obtained central warehouse delivery of Coca-Cola in cans have continued to purchase it in bottles delivered directly to their retail outlets. Thus we find unwarranted the assumption that high-volume accounts will disappear from store-door delivery routes. (See also Text at 74-76 infra).

Moreover, the efficiency of a store-door route depends upon such factors as the number of customers on the truck route, the volume of soft drinks delivered to each customer, the distances between customers, and the time required to make each delivery. These factors may vary greatly on different routes, in different territories, in various competitive situations. 58/ Consequently, a bottler can achieve delivery efficiencies by adjusting the type of accounts serviced on each route by each of his trucks. Such route adjustments are not unknown in the industry. (Tr. 4044). 59/ Bottlers are, for example, flexible in adjusting their routes in response to fluctuation in demand for soft drinks caused, for example, by seasonal variations (Tr. 2567, IDF 38, Stip. No. 3, CX 1244G, Tr. 476) or by the addition of piggybacked brands which they

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58/ Under the present system, for example, virtually all products are distributed on a store-door delivery basis and costs vary from one territory to another. In Hartwell, Ga., the bottler's break-even point per delivery is four cases (Tr. 1370-71); in Coatesville, Pennsylvania, on his scheduled routes, the bottler's break-even point is five cases (Tr. 2191); in San Antonio, Texas, the bottler estimated that he broke even on deliveries involving about six cases. (Tr. 2554-55).

59/ It has been suggested that central warehouse delivery would siphon away 50 percent of the store-door delivery volume in most territories. This assumption, however, is speculative. The record shows that chain stores, large independent supermarkets,

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may distribute to customers who are located beyond the limits of their primary territory. (See Tr. 2848-56, 3064-69). In addition, delivery costs may be reduced by route adjustments which eliminate deliveries to unprofitable accounts or by establishing a minimum volume which the bottler will deliver to a customer's place of business. (See Tr. 1932, 2554). We recognize, of course, that some territories may be too small and the returnable bottle volume too insubstantial to allow a bottler to operate efficiently. A similar problem exists under respondents' territorial system. Yet in such circumstances in which a bottler is unable to compete in returnable bottle sales, he may merge or consolidate his territory and plant with that of another bottler, as respondents now recommend to their small bottlers as a means of increasing their volume and efficiency. (Tr. 615). For these reasons, we conclude that territorial

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and convenience stores which are serviced by warehouses for other food items, as a class of customers, account for about 20 percent of the total sales of the bottlers of Coca-Cola nationwide. Within various territories, the percentage varies. In Washington, D.C., this customer class accounts for about 27 percent of the bottlers' sales; in Herminie, Pa. about 20 percent; in Wilmington, about 33 percent; in Belmont, Calif. about 60-65 percent; in Westminster, Md., about 18-20 percent. (RPF 325).

We note, in addition, that the fact these customers are serviced by warehouses for other food items does not mean that all or any specific portion of their requirements for Coca-Cola would be centrally warehoused. (See Text at 75-77 with accompanying notes, infra). For example, the percentage of the bottlers' sales volume which is packaged in refillable bottles and the large sizes of nonrefillable bottles may continue to be delivered store-door to the retail outlets of these customers. Consequently, that portion of the bottlers' total sales volume which may actually be centrally warehoused will probably be, in many instances, signficantly less than the bottlers' total sales volume to the class of customers who are serviced by warehouses for other food items.

restrictions which cover a bottler's entire package mix are not justified because part of the mix includes the use of refillable bottles. 60/

VII. "Small Bottlers"

Respondents contend that an order eliminating the territorial restrictions which they impose on their bottlers would result in a restructured, highly concentrated industry dominated by a few large bottlers. Reversing the thrust of their own argument that interbrand competition now places limits on the extent to which their bottlers, both large and small, may increase their prices, respondents assert, "in this concentrated economic environment (i.e., an environment free of respondents' territorial restrictions) in which hundreds of small bottlers 61/ had been forced out of business," wholesale prices would rise. (Ans. Br. 57).

60/ As we previously mentioned, prior to 1955, finished Coca-Cola was packaged solely in refillable bottles. Respondents' practice now applies to the bottlers' entire package mix, of refillables and nonrefillables, and we considered the effects of the restraint in that context. Under our order, a market context will prevail in which intrabrand competition will be fostered in the sale of Coca-Cola and allied products packaged in nonreturnable containers. Under these circumstances, we believe the restraint, if limited to refillable bottles, is reasonable for the reasons discussed above. There is no occasion to determine whether the restraint, before the introduction of nonrefillables, was reasonable as applied solely to sale of Coca-Cola in refillable bottles prior to 1955.

We should emphasize that our finding of reasonableness here is also limited to the use of refillable bottles. We note, for example, that no evidence was adduced that intrabrand competition would unduly burden the use of refillable containers which may be used in pre-mix or post-mix systems. These pre-mix and post-mix systems, unlike the refillable bottles, remain with the retailer who dispenses the beverage. Thus, it is significant that respondent Coca-Cola successfully packages and sells its fountain syrup in refillable five-gallon stainless steel tanks (Tr. 3773), even though the fountain wholesalers are not confined by territorial restrictions. In fact, the recapture and return system for post-mix containers seems to work well in view of the fact that The Coca-Cola Company has found it unnecessary to impose a deposit refundable upon the container's return. (Tr. 3773-74). As a prophylactic measure against the imposition of the restraint in the future, our order will cover post-mix syrup sales and distribution.

61/ At the time of his testimony at the trial, the President of The Coca-Cola Company could not define the term "small bottler," and when asked by Judge Dufresne "what is a small bottler?" he testified: "Well, I don't know, sir ... [w]e have never really tried to make such a definition." (Tr. 590-91). The term "small bottler" is, of course, a relative term. Subsequent witnesses noted that the relative size of a bottler may be measured by

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Respondents' concern about a market structure in which their bottlers are competing intrabrand in the sale of Coca-Cola and allied products is indeed a curious defense of territorial restrictions which allow one bottler to be the sole source of supply of these products to the customers within his territory. Contrary to respondents' assertions, the removal of the restraints would probably result in a substantial reduction in concentration as existing independent Coca-Cola bottlers expand geographically to encompass the previously captive retail outlets of other bottlers in areas they are now forbidden to penetrate. Rather than reducing competition and increasing concentration, the elimination of territorial restrictions will probably increase both actual and potential competition and decrease concentration.

1. Territorial Restrictions as a Method of Protecting Small Business

Respondents' protestations about concentration and the future structure of the industry aside, the thrust of their argument is predicated on the notion that small independent Coca-Cola bottlers would be unfairly disadvantaged by intrabrand competition. Numerous bottlers, particularly the smaller bottlers, testified that they were dependent upon the refuge of their territorial enclaves because intrabrand competition would force them out of business. 62/ This assessment was, in

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the population in his territory, his annual case sales of soft drinks, and the number of people he employs. (RPF 279). The Small Business Administration classifies a manufacturer with less than 250 employees as a small business. In 1974 respondents conducted a census of Coca-Cola bottlers, and of the 567 bottlers who responded, representing about 75 percent of domestic bottlers of Coca-Cola, 529 had fewer than 200 employees. (RPF 284). In this proceeding, however, the term "small bottler" has been used primarily as a reference which encompasses a number of factors, such as a bottler's sales volume, production capacity, proximity to central warehouse customers, and his access to capital resources, among others, which are said to give one bottler a competitive advantage over neighboring bottlers.

62/ It is a questionable hypothesis as to whether territorial restrictions promote the viability of small business in view of the fact that they necessitate survival for many small bottlers by merger, rather than growth by internal expansion. Between 1968 and 1971 there were 107 bottling plant mergers among Coca-Cola bottlers. (Tr. 650-51). In addition, respondent Coca-Cola has issued 14 temporary marketing bottler agreements, pursuant to which bottlers who have discontinued production continue to distribute, within their territories, Coca-Cola produced for them by neighboring bottlers. (CX 1245 A-M, CX 1246 A-J). When these agreements expire, The Coca-Cola Company does not intend to renew them. (Tr. 900). The marketing bottlers will then have the option to resume bottling or merge their territories with some other bottler. (Tr. 901).

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turn, based on several assumptions which were adopted in a series of important findings in the initial decision. 63/ The judge concluded that without exclusive territories, large bottlers of Coca-Cola would drive smaller bottlers out of business. He further concluded that a Commission order lifting the territorial restrictions:

> ... would be in direct conflict with the purpose of the Congress in enacting and in agencies administering the antitrust laws ". . . to perpetuate and preserve, for its own sake in spite of possible cost, an organization of industry in small units which can effectively compete with each other." U.S. v. Aluminum Co. of America, 148 F.2d 416, 429 (2d Cir. 1945).

We acknowledge this admonition that one of the underlying purposes of the antitrust laws is to protect and preserve small business; indeed, in American Cyanamid 64/, the Commission noted that "This agency also has its very roots planted in that philosophy...." Our previous decisions implementing this philosophy clearly indicate, however, that we have never condoned anticompetitive practices solely for the purpose of eliminating competition between large and small firms. We stated in Procter & Gamble:

> ... it may be appropriate ... to note Congress' concern with the preservation (of small firms), to the extent compatible with social and economic progress, of the fundamental benefits of a small-business, decentralized economy. The interest of fostering equality of opportunity for small business and in promoting the diffusion of economic power ... was unquestionably intended by Congress to be relevant in any scheme for the enforcement of Section 7. (63 F.T.C. 1465, 1555-56 (1963)).

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According to the President of The Coca-Cola Company, the demise of small independent units of production under its system is a function of improvements in transportation, economies of scale, shifting population, changing tastes, and income patterns which "have tended to reduce the number of bottling plants and increase the size of some territories." (Tr. 614). In circumstances in which bottlers are too small to operate efficiently and foreclosed by territorial restrictions from significant internal expansion, respondents recommend that they merge or consolidate their production with another bottler (Tr. 615; see also Tr. 900-01), thus reducing the population of small bottlers.

63/ See IDF 185-193.

64/ 63 FTC 1747, 1857-58 (1968).

But in effectuating this policy, the Commission made clear that it does not subordinate "the protection of competition to the protection of small business competitors." (Id. citations omitted; Compare Ans. Br. at 66-67). "Otherwise," as the Third Circuit has observed in another context, "what is intended as a shield for small competitors becomes a sword against the consumer." NBO Industries Treadway Cos., Inc., v. Brunswick Corp., 523 F.2d 262, 279 (3rd Cir. 1975), vacated on other grounds and remanded, Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., __ U.S. ___, 1977-1 Trade Cases, ¶61,255.

Consistent with our prior application of these principles, we conclude that territorial restrictions are not justified as a means of protecting small independent Coca-Cola bottlers from large independent intrabrand rivals, but that ancillary relief is necessary, in the public interest, to prevent The Coca-Cola Company's integrated bottling operations from exploiting certain advantages which may accrue to it as a dual-distributing trademark licensor.

a. Large Independent Bottlers v. Small Independent Bottlers

Recognizing that all of the bottlers who testified in this proceeding were concerned about intrabrand price competition within their respective territories, respondents and the bottler intervenors also adduced evidence from which it may be concluded that respondents' territorial policy is today the chief reason why many bottlers remain small. With access barred to retail accounts in densely populated areas now under the lucrative intrabrand domain of the metropolitan bottlers, expansion by a small bottler largely depends, absent a territorial merger, on population growth in his territory and per capita consumption of his product. Under these circumstances, large bottlers in the nation's major cities may be the principal benefactors of the "special protection" these restraints afford. (Tr. 872). 65/

The record shows that small bottlers, in some instances, may have overall cost advantages because, among other reasons, they have lower labor and land costs and lower taxes than large bottlers located in major metropolitan areas. (RPF 191, 290; see Tr. 2248, 2363). In fact, wholesale prices charged by large bottlers with high-speed, high-volume production facilities are often higher than the prices charged by small bottlers in adjacent territories. (RPF 295; Tr. 2179-80, 2832). Respondents submit this pricing behavior as evidence that many small bottlers may actually be more efficient overall than large

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65/ In one instance noted in the record, territorial restrictions prevented a small Coca-Cola bottler from doubling his annual volume by selling canned Coca-Cola to a customer who intended to transship out of the small bottler's territory. (Tr. 665-66).

bottlers. (Ans. Br. 82; RPF 295, 188). 66/ This evidence adduced by respondents from bottler witnesses tends to contradict their argument that small bottlers as a class would be unable either to defend their existing sales volumes or expand out of territories in which low costs and prices prevail into the territories of large bottlers who may be incurring higher costs and charging higher prices as a consequence. (*See* RPF 188, Tr. 881-86). Certainly, no prudent retailer of Coca-Cola and the allied products would continue to patronize a large bottler exclusively if he were able to purchase all or a portion of his products at a lower price from a competing

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66/ Although the record is silent with respect to the bottling or canning plant volume necessary to achieve full economies of scale, bottlers who have merged their geographic markets and consolidated their operations testified that they have improved their bottling line efficiency. According to respondents' expert, however, the relative economies of production between large and small bottling plants are not a "big factor" in the soft drink bottling business. (Tr. 1044). With respect to canning operations, the production efficiencies of large canning lines average 3-5 cents per case (Meyers 1737-38), and this obviously may be a significant competitive factor. (*See* Tr. 3179).

However, nothing in the record suggests that economies of scale are any different for Coca-Cola bottlers than they are for Pepsi-Cola bottlers. Thus it is relevant, in assessing the relative advantage scale economies afford firms of different size, that "small" Coca-Cola bottlers effectively compete with "large" interbrand bottlers. The bottler in Hartwell, Ga., for example, has an annual sales volume of about 340,000 cases in a territory serving 35,000 people (RPF 280, 283); yet he apparently suffers no overall cost disadvantage despite the fact that Pepsi-Cola is sold in his territory by a bottling operation of General Cinema Corporation, which "owns North Georgia -- and most of Florida." (Tr. 1390-93; *See also* Tr. 1671A-73). In a reverse situation, the viability of small Pepsi bottlers apparently was not threatened despite the fact that their territories were encompassed by the territory of the huge Coca-Cola Bottling Co. of New York. (Tr. 2276-78).

supplier. (See Tr. 3179). 67/ In effect, then, territorial restrictions may, in some instances, be preventing small bottlers from fairly exploiting the competitive advantages which, in open markets, would ordinarily accrue to those who offer lower prices. 68/

67/ The judge found that small bottlers do not have the production capacity to compete effectively for the business of the large chain store accounts.

Yet not only is the record unclear concerning the output capacity which would be required to serve all or part of the demand of large retailers from time to time, the finding ignores the fact that a bottler's ability to supply large-volume accounts does not necessarily depend on his in-house production capacity alone. Bottlers have, in the past, supplemented their production capacity by entering into agency canning agreements with contract canners (Tr. 837-38, see Tr. 3153-54), and as the record shows, the canned product is ideally suited to central warehousing. (supra fn. 25). Nothing in the record suggests that these canners could not produce canned Coca-Cola for small bottlers at prices which are competitive with the in-house canning lines of large bottlers. (Compare Ans. Br. 63, Fn. 70; Tr. 1325-26). Nor is there any evidence in this record which would suggest that those retailers which presently backhaul private label soft drinks produced for them by contract canners would not, except where local union contracts prevent it, backhaul Coca-Cola directly from a contract canning plant to the chain store warehouse.

In addition to contract canning as a means of boosting the capacity to supply a product, the record also shows that small bottlers can overcome capital barriers by joining together in cooperative soft drink canning ventures, such as the Mid-Atlantic Canning Association owned by 16 bottlers, including many small bottlers. (Tr. 2138, 2923-25, 1500, 1561, 1771-73, 2042). In these ways, small bottlers have arranged for additional production capacity to meet the demands in the markets they serve. Should the demand for the small bottler's product increase, the barriers would not appear to be insurmountable for those who attempt to accommodate it.

68/ The administrative law judge concluded that small Coca-Cola bottlers would not have the financial resources to meet the price reductions intrabrand competition may stimulate. While numerous bottlers did, in fact, express concerns about the financial resources of their neighbors, the record also shows that "small" bottlers have been able to price compete with larger, so-called deep-pocket interbrand bottlers serving customers within the small bottlers' territorial boundaries.

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2. <u>Competition for the Business of the High-Volume Chain Store Accounts</u>

Although the judge found that small bottlers are often located near large bottlers (IDF 186), he also found that large bottlers in metropolitan markets would have a competitive edge over small bottlers for important central warehouse accounts "because chain store warehouses are located mainly in territories of large bottlers." (IDF 185; RPF 329, 333). At the outset, we reject the notion that trade-restrictive territorial practices can be sanctioned as a means of eliminating fair advantages which may accrue to a bottler by virtue of his proximity to customers.

Beyond that, we find little in the record to support the judge's sweeping conclusions in IDF 185. While several bottlers testified that many chain store warehouses are located within the present territorial boundaries of large bottlers, there is scant evidence reflecting shipping distances or the relative "proximities" of large and small bottling facilities to the various chain store warehouse facilities. In fact, food store warehouses which may be located on the outer fringe of the territory of a large urban bottler could actually be closer to the production plant of a small suburban or rural bottler than the plant or distribution facility of the bottler in whose territory the warehouse is actually located. (IDF 186). The judge cited evidence indicating that the Baltimore Coca-Cola bottling facility of The Coca-Cola Company may be closer to an A & P warehouse than the bottling facility of the Westminster, Maryland, Coca-Cola bottler. (IDF 188). 69/ But neither this example nor the fact that some central warehouses may be located within the territories of some large bottlers, but at undisclosed distances from bottling plants or distribution centers, supports a general conclusion that because of transportation disadvantages,

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As in many sectors of the economy in which large and small businesses compete, it is the large firms which usually possess the greatest financial resources, if not superior efficiencies. The soft drink bottling industry is no exception. But the disparity in the financial strength among various firms in a market is not, by itself, an accurate indicator of the ability of any particular firm, large or small, to compete effectively in the market.

69/ In contrast with the testimony of the former president of respondent's bottling operation in Baltimore, cited in IDF 188, the small 7-Up/RC bottler in Herminie, Pennsylvania, testified that he has two potential warehouse customers in his territory which are located 20-30 minutes from his plant, but one hour from the plant of the large bottler of 7-Up and Royal Crown Cola in Pittsburgh. (Tr. 2823, <u>But see</u> Tr. 1783-84).

small bottlers would be unable to compete effectively for the business of high-volume retailers. The bottlers' prices are influenced by many factors, including their overall costs. As a result, a bottler who enjoys, by virtue of his location, a delivery-cost advantage with respect to one customer may be disadvantaged by his location vis-a-vis another bottler and other customers or by cost disadvantages he may incur in other aspects of his operation.

a. Central Warehouse Delivery and Backhauling by Central Warehouse Customers

Furthermore, the judge ignored the fact that respondents' territorial boundaries are no measure of the distances finished soft drinks may be shipped economically. Small bottlers presently haul and backhaul Coca-Cola efficiently from their bottling or cooperatively owned canning plants to their distribution facilities 70/, and they often transport the canned and bottled products produced for them by contract canners or other bottlers under agency arrangements over routes which sometimes traverse the territories of large neighboring bottlers. It is therefore likely that sizable portions of a large bottler's territory, and the customers within it, may lie within an area which small neighbors might effectively service.

Moreover, while backhauling by high-volume soft drink retailers from the canning plants of contract canners to their central warehouses is a customary mode of private label soft drink distribution (Stip. No. 7, Tr. 2998) 71/, respondents

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70/ For example, the 7-Up/Royal Crown bottler in Herminie, Pa., also owns the 7-Up franchise in Wheeling, W. Va. He testified that he ships soft drinks packaged in 28-ounce nonreturnable bottles from his Wheeling facility to his Herminie facility on a route which passes through the territory of the large Pittsburgh bottlers; however, because of the restrictions imposed upon his territories, he may not sell soft drinks at wholesale in the Pittsburgh territory. While this bottler would not consider it feasible to sell returnable bottles in Pittsburgh because of the problem of recapturing the empties (Tr. 2849-50), he testified that it would be feasible for him to sell nonreturnable bottles in Pittsburgh (Tr. 2853-54), although if he did so, he would expect the bottlers there to respond by competing for customers in his territory. (Tr. 2855).

71/ In one instance noted in the record, canned Coca-Cola is being backhauled by a bottler's customer. The Alpha-Beta chain in Los Angeles is presently backhauling canned Coca-Cola from the Los Angeles Coca-Cola bottler to its central warehouse and subsequently transshipping it in its own trucks to Alpha-Beta retail outlets located in the territories of neighboring Coca-Cola bottlers. (Tr. 2584-85, 2588, 2634, 2650-51).

discount its importance as a means of distributing Coca-Cola and allied products. They claim the chain store trucks servicing the retail stores in the territories of small bottlers could not feasibly backhaul Coca-Cola from the bottlers' plants. The judge below agreed with this contention. Relying upon respondents' proposed finding of fact, he cited three witnesses in support of the conclusion that a small bottler could not supply chain store warehouses by allowing backhauling "because the chain store truck servicing the few stores in that territory would not have enough room to pick up a significant supply on a backhaul." (IDF 188). 72/ We find the reference to "significant supply" vague in this context 73/, but assuming it relates to the bottlers' sales volumes, the testimony upon which it is presumably predicated is hardly a compelling basis for the finding.

Mr. Rooks, the Coca-Cola bottler in Hartwell, Georgia, testified that the chains may have "space problems" on the trucks which deliver to the retail chain outlets in his territory (Tr. 1417); and Mr. Christian, the President of the Charlottesville, Virginia, Coca-Cola Bottling Works, testified that he thought the chain stores could backhaul on the trucks they use to service their outlets in his territory, but he assumed the chain store trucks were, in fact, already backhauling other items. (Tr. 1843). Despite these assumptions, neither of these witnesses testified concerning the number of trucks servicing the chain outlets in their respective territories; the frequency of the chain store deliveries to these

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72/ Compare IDF 188 with RPF 333.

73/ It is unclear whether this finding refers to a supply of soft drinks which chain store customers might consider "significant" or a sales volume which the bottler would consider significant. However, no chain store customers were called to testify at the trial, and the record does not show what quantity of soft drinks any retailer would consider significant on a backhaul, although presumably a customer interested in backhauling from a particular bottler might consider, among other factors, how far removed the pick-up point is from the delivery truck's normal route, the quantity of soft drinks it requires and the bottler has available, and the price at which the soft drinks are being offered.

outlets; the amount of space, if any, which might actually be available on these trucks from time to time; or the amount of space the bottlers thought they would require to permit the backhauling of a "significant" volume of soft drinks. 74/ The third witness cited by the judge, Mr. Roadcap, President of the Westminster, Md., Coca-Cola Bottling Company, doubted that backhauling would be feasible for reasons entirely unrelated to speculations about truck capacities in backhaul situations.

74/ In finding 188, the judge, relying on the testimony of Mr. Hornsby, Executive Vice President and Treasurer of the K-S Canning Co., noted that an empty tractor trailer truck can accommodate 1800 to 1900 cases of 12-ounce cans. (Tr. 3175). (Both respondents' proposed finding of fact No. 333 and the judge's finding of fact IDF 188 erroneously cite Mr. Meyers, former President of Shasta Beverages, as the source of this statement.) While accurate in substance, the context in which this fact is used in IDF 188 seems to suggest that a tractor trailer truck, if used by a chain store to deliver other food items to retail stores in a bottler's territory, could not, even if empty, backhaul "significant" supplies of Coca-Cola. Considered in light of other facts presented at the trial, the first two findings in IDF 188 lack the scope necessary to give them any realistic perspective.

Recognizing that we cannot, on this record, state definitively the chain store backhaul capacity, if any, which may be available to individual bottlers, we note that if one empty tractor trailer truck, or its equivalent from partial truckloads backhauled by several customers, were available to a bottler once a week, for example, it would provide a backhaul capacity of approximately 100,000 cases of cans annually, or the equivalent volume of about 150,000 statistical cases of 24 8-ounce bottles. We note further that the record shows this would be more than sufficient to haul the total annual soft drink volume many small bottlers now sell to chain store customers. (But see fn. 59 supra).

Mr. Rooks of Hartwell, Georgia, for example, had total sales of 340,000 statistical cases (Tr. 1422, RPF 283), but only 25 percent of his sales went to customers with warehouse facilities. (Tr. 1371, 1438; RPF 325). Consequently, a backhaul capacity of about 85,000 statistical cases would maintain his sales volume to chain store customers.

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Mr. Roadcap stated that, backhauling would not be feasible because other Coca-Cola bottlers would find out that he had allowed Coca-Cola to be shipped into their territories, and in his judgment, "they would keep cutting the cost and it would go down, down, down to the point no one would make money...." (Tr. 2459).

Whether backhauling would always be feasible for all of respondents' bottlers and their customers cannot be gleaned from this record, but neither was it complaint counsel's burden to disprove respondents' contentions that individual backhaul situations, in some cases, might not be feasible. Absolute competitive equality among bottlers was not a prerequisite of their case. The fact that a particular delivery mode may not be feasible for some does not justify a restriction which virtually precludes all bottlers from freely using it.

b. Store-Door Delivery to Central Warehouse Customers

While instances in which respondents' bottlers have offered delivery services other than store-door delivery are, as a consequence of respondents' efforts to preserve their territorial arrangements, admittedly rare, actual warehouse delivery situations are not unprecedented even within respondents' bottling network. 75/ And limited though this experience may be, it shows that bottlers can provide, and their customers have accepted, both warehouse delivery of Coca-Cola in certain types of packages, such as cans, and store-door delivery of

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Similarly, while Mr. Roadcap's testimony about the feasibility of backhauling was concerned with other matters, the record shows that he has total sales of about 500,000 statistical cases (Tr. 2434-35, RPF 283), but only 20 percent of his total represented sales to customers which are served by warehouses for other food items. (Tr. 2436, 2438; RPF 325). An annual backhaul capacity of 100,000 statistical cases would maintain his sales volume to chain store customers.

75/ The record shows that in the early '60s a group of Coca-Cola bottlers on the west coast entered into a cooperative agreement for the purpose of experimenting with warehouse delivery of Coca-Cola in cans through the Safeway, Lucky, and Purity food chains. According to respondents and the bottlers, these experiments failed. While the bottlers were apparently dissatisfied with the way some store managers at the retail outlets were merchandising the product after the chains had purchased it,

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Coca-Cola in bottles. 76/ Indeed there 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.

3. Store-door Delivery to Customers Without Central Warehousing

The record further shows that 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. While chain stores, large independent supermarkets, and convenience stores serviced by warehouses are important to

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it is arguable that merchandising decisions in individual retail outlets, such as the number of shelf-facings a product will receive in a store, are not misplaced if left to the discretion of the retailer who buys the product for resale.

Nor does the record show that these experiments demonstrate the failure of split delivery. The tests lasted several years during which time, participating customers who picked up Coca-Cola in cans from the canning plant and backhauled it in their own trucks to their respective warehouses (Tr. 2623) still purchased bottled Coca-Cola from individual bottlers for store-door delivery to the chain store retail outlets. (RPF 110). Although respondents claim such delivery is infeasible, these early tests with central warehousing involved split delivery to a significant degree. Nor are they of purely historical significance.

As we noted previously, the record shows that the Alpha-Beta chain receives at its warehouse canned Coca-Cola which it obtains from the Los Angeles Coca-Cola bottler and transships into the territories of neighboring bottlers; Alpha-Beta, however, still purchases Coca-Cola in returnable bottles delivered store-door by the bottlers in the territories in which its retail stores are located. (Tr. 2584-85, 2588, 2634, 2650-51; *See also* Tr. 3575-76).

76/ On the large size bottles, for example, store-door delivery may be more efficient than central-warehouse delivery. (Tr. 3438-39).

the bottlers (RPF 325), in the largest metropolitan areas, as much as 73 percent of the bottlers' volume is delivered on a store-door basis. 77/ (Tr. 2309-09). Although a part of this volume may represent sales in refillable bottles, the exclusivity of which will remain undisturbed, store-door delivery of nonrefillable containers in these metropolitan areas still holds substantial opportunities for growth and market expansion by small bottlers.

4. Territorial Restrictions Foreclose Fair Intrabrand Competition in the Sale of Coca-Cola and Allied Products Packaged in Nonrefillable Bottles and Cans

While larger and potentially more fertile markets would, absent the restraint, open to small bottlers, we acknowledge that the free market provides no assurance that all of respondents' bottlers will compete effectively or thrive in an unsheltered environment. 78/ Nevertheless, we reject respondents' contentions that the antitrust laws embody a pledge to protect

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77/ For example, in New York about 70,000 accounts purchase Coca-Cola; in Washington, D.C., 15,000 accounts purchase it; 6,400 accounts purchase it in Richmond; 12,000 accounts purchase it in San Antonio, Texas; and 3,000 accounts purchase it in Wilmington, Delaware. In contrast, the small bottlers in Annapolis, Maryland, and Charlottesville, Virginia, service 1,335 and 1,375 accounts respectively. The bottler in Westminster, Maryland, services a total of about 1,000 accounts and the Coatesville, Pennsylvania, bottler services about 1,200 accounts. The Dover, Delaware, bottler services a total of about 650 accounts while the neighboring bottler in Wilmington services about 300 Mom and Pop stores alone. (RPF 225).

Respondents correctly assert that in the absence of exclusive territories, a big bottler may compete intrabrand for the relatively few accounts the small bottlers presently serve, but the potential for a small bottler to expand might include thousands of accounts now foreclosed to him.

78/ We noted previously that many small bottlers have been locked into territories that are so small they cannot generate enough volume to support an independent bottling operation. Thus the number of small bottlers forced to merge with or sell out to neighboring bottlers is substantial. The record shows that the survival of the independent small business unit of production and distribution of Coca-Cola and allied products is, under respondents territorial system, threatened in numerous instances by inescapable inefficiency due to their confinement in small territories. (Tr. 615, 895-901).

small bottlers from competitive risk and that The Coca-Cola Company may redeem the pledge by keeping captive the demand side of a market which includes soft drink retailers from coast to coast and indirectly the consuming public served by those retailers.

Respondents simply misapply the thrust of our decisions and those of appellate tribunals directed toward the preservation of small business. The precedents respondents invoke, for example, involve situations in which anticompetitive behavior, such as monopolization 79/, merger activity 80/, exclusive dealing-type franchise arrangements which impede independent franchisees from purchasing supplies from their franchisor's competitors, 81/, boycotting 82/, and discriminatory pricing or promotional practices in violation of the Robinson-Patman Act 83/, were condemned by this Commission or the courts. These cases, to the extent they implement the concern of Congress for the preservation of small business, demonstrate a strong public policy to protect small business, not from open and fair competition, but from unfair anticompetitive acts and practices of larger rivals. In essence, the decisions concerned with small business problems issued by appellate tribunals share in common the singular proposition that small business may be shielded from the unfair, anticompetitive practices large firms sometimes employ against them, but the case law is equally clear that the antitrust laws afford small business, as a class, no license to engage in anticompetitive market segmentation activity for its own protection (See Topco, supra); nor do we find in them sanction for the patronage of respondents' anticompetitive activities, presumably on behalf of the small bottlers.

The threat of competitive confrontation between large and small independent bottlers is alone not enough to justify the imposition of a restraint preventing consummation of the threat. To conclude otherwise would, in our judgment, clearly represent a novel departure from free market principles; neither the precedents cited by respondents and the judge nor the circumstances revealed in this record lend any support for it.

79/ U.S. v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

80/ F.T.C. v. Procter & Gamble Co., 386 U.S. 568 (1967); Brown Shoe Co. v. U.S., 370 U.S. 294 (1962); National Tea Co., 69 F.T.C. 226 (1965).

81/ Brown Shoe Co., 62 F.T.C. 679 (1963).

82/ Fashion Originators' Guild v. F.T.C., 312 U.S. 457 (1941).

83/ F.T.C. v. Fred Meyer, Inc., 390 U.S. 341 (1968).

5. Independent Bottlers v. The Domestic Bottlers' Subsidiaries of The Coca-Cola Company (DBS)

Intervenors' most vigorous objections to an order lifting territorial restrictions concern the competitive imbalance which they assert might exist between the independent bottlers and The Coca-Cola Company's DBS operations. Intervenors contend that The Coca-Cola Company, as a dual-distributing trademark licensor, may have critical advantages over its bottlers, unrelated to the efficiency of its syrup-producing and bottling integration. We have carefully considered the evidence relating to the competitive imbalance which intervenors perceive.

a. Respondents' Access to Confidential Trade Information

The record shows that the The Coca-Cola Company, in the course of its business as a trademark licensor and syrup supplier, acquires detailed and sensitive, competitive information about each of its bottler's business operations. For example, during routine quality control inspections of bottling plants, respondents can obtain access to the type of information which may reflect a bottler's production capacities and competitive capabilities, including the innovations and methods a bottler may employ to reduce his production-line or plant costs, or increase his capacity and competitive potential. 84/ In addition, a bottler must obtain The Coca-Cola Company's approval before using new, previously unauthorized types of packaging, and as the record amply demonstrates, packaging decisions in this industry can be a vital aspect of a bottler's marketing strategy. (RPF 253). The Coca-Cola Company would have advance knowledge of, and the right to approve, new packaging innovation and, unlike its independent bottlers, could begin to react to a bottler's innovation before it was actually introduced into the market.

84/ While it may have, in the past, been beneficial to the overall efficiency of the Coca-Cola and allied product bottling network for each bottler within it to pass on useful commercial information to other bottlers, such efficiencies may not be possible and may have to be sacrificed to some degree in the interest of preserving the free market. In these circumstances, as Bork has observed, a manufacturer:

> ... is much less likely to make known to others in the system any particularly successful selling or manufacturing techniques it devises if there is a substantial possibility that such techniques will be used to take business away from it. (Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 Yale L. J. 373 (1966) at 439-40.

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The sensitivity of this type of information is further evidenced by the fact that The Coca-Cola Company itself argued persuasively for in camera treatment in this proceeding of similar types of commercial data in order to prevent it from falling into the hands of syrup company competitors and their bottlers (Tr. 486-87; CX 1-2, in camera), and complaint counsel agreed the request was not "wholly without merit." Thus it appears that, as trademark licensors, respondents' relationship with their bottlers is more in the nature of a fiduciary than a competitor. (Tr. 487). Under these circumstances, we believe it would be inequitable and unfair to ignore intervenors' concern that the bottling operations of the trademark licensor may easily obtain access to competitively sensitive information and may easily exploit the advantages this would give them.

Our order will, therefore, require respondents to safeguard the information they acquire from their independent bottler licensees in the course of respondents' business as trademark licensors and syrup suppliers. Disclosure of this type of information to those of respondents' employees involved in or responsible for the production and sale of finished soft drinks will be prohibited. Respondents will also be enjoined, pursuant to paragraph II F. of our order, from enforcing or aiding in the enforcement of plant inspection provisions incorporated into licensing agreements, which respondents have approved or consented to, between any bottler and the bottler's sub-bottlers, term sub-bottlers, or temporary bottlers. (See, e.g., CX 20B Para. (f), CX 35C Para. (f), CX 36D Para. (f)). This provision is necessary to prevent exploitation and competitive abuse of information which may be acquired by bottler/licensors, and should impose no undue

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If a firm cannot be protected by a market division agreement from the danger of the "free rider," it probably would, in its own interest, cut off the information flow. (Id. at 445). Certainly an independent bottler would not, voluntarily, yield his production and marketing ideas and strategies to any direct competitor. It is true that much of the data, such as monthly sales to chain stores and planned promotions, is apparently supplied voluntarily by independent bottlers to The Coca-Cola Company. This type of data presumably could be withheld if it were in the bottlers' interest to do so. Other types of information, however, concerning the independent bottlers' plant facilities and production capacities, for example, would as a consequence of the trademark licensing relationship, be extremely difficult for the bottler to withhold or safeguard.

burden upon respondents' quality control program in view of the fact that respondents retain the right to inspect the sub-bottlers' facilities, and the further fact that respondents customarily conduct inspections of every plant at which soft drinks bearing their trademarks are produced. The injunction will, however, include an exception which will allow respondents to continue to fill orders for finished packaged soft drinks from licensed Coca-Cola and allied product bottlers pursuant to agency bottling or canning agreements.

b. Divestiture Stipulation

The bottlers also contend, however, that divestiture of integrated bottling operations by respondent Coca-Cola and other integrated syrup companies would be the only effective way of dealing with unrestrained dual distribution in this industry. (See Ans. Br. by Coca-Cola Bottling Company of Los Angeles, et al., Para. at 33-34). The Coca-Cola Company and its bottlers have negotiated a stipulation pursuant to which respondent Coca-Cola has agreed not to object to a divestiture order, provided the Commission enters equivalent relief against seven other syrup suppliers. 85/ Yet we cannot, in the abstract, endorse a proposal premised on remedies in cases not yet adjudicated; nor are we, on the record before us, prepared to decide a general rule of vertical divestiture, including situations possibly involving de novo entry or toe-hold entry by acquisition, which could rule out the potential efficiencies of integration as well as the potential pro-competitive effects it may have in this industry. Certainly, nothing in this record demonstrates that such measures would be appropriate. To the contrary, although we reserve judgment on cases involving other syrup companies now pending before the administrative law judge, it is not inconceivable that vertical integration by acquisition or de novo entry into bottling might be justified by a smaller syrup company attempting to piece together a nationwide bottler distribution network to compete with

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85/ The divestiture stipulation is limited by the following caveat:

> ... the other seven manufacturers of nationally branded soft drink syrups against whom the Commission now has complaints pending and their subsidiaries and affiliates are required by the Federal Trade Commission, in Docket Nos. 8853 (Crush International, Limited), 8854 (Dr. Pepper Co.), 8856 (PepsiCo, Inc.), 8857 (The Seven-Up Co.), 8858 (The Royal Crown Co.), 8859 (National Industries, Inc.) and 8877 (Norton Simon, Inc.), to divest and do divest all other bottling, canning, and distributing operations.... (Tr. 4104-05; Stipulation No. 10, Docket Binder 1-3-3, filed June 27, 1975).

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the industry giants such as The Coca-Cola Company and PepsiCo. (See Text at 12, fn. 14 supra). Nor is there sufficient independent record basis for extraordinary divestiture relief against respondents in this proceeding. 86/

The burden of establishing the necessity of ancillary relief, such as divestiture or supply limitations in the nature of covenants not to compete, rests with the party asserting the need for such protection. Frequently, this burden is assumed by government counsel in cases in which it appears that ancillary relief is necessary in the public interest to preserve the competition fostered by the primary remedies of antitrust litigation, Ford Motor Co. v. U.S., 405 U.S. 562 (1972); L. G. Balfour Co. v. F.T.C., 9 S&D 26, 56 (7th Cir. 1971); Luria Bros. & Co., Inc. v. F.T.C., 8 S&D 615 (3rd Cir. 1968), by intervenors who seek to protect interests they believe will not be adequately represented by the parties, Ford Motor Co. v. U.S., supra, or by plaintiffs in private treble damage actions. Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., supra at 70,775. But as the court observed in Papercraft Corp. v. F.T.C., 9 S&D 530, 536 (7th Cir. 1973), "... divestiture orders have included special provisions designed to insure the survival of the divested business, but in each instance the supporting findings demonstrated the need for a special protective provision." No evidence of need for ancillary divestiture relief has been adduced in this case.

86/ Intervenors note that The Coca-Cola Company has the capacity to exploit its resources as a dual-distributing syrup producer for the purpose of increasing the market share of its bottling subsidiaries. Citing the testimony of John H. Ogden, Executive Vice-President of Coca-Cola U.S.A., intervenors point out that respondent's Chicago DBS has, since 1975, incurred losses because its management viewed that territory as "an area for investment spending, believing that leadership in a market ultimately moves to a profitable position." (Tr. 840-41). While intervenors emphasize that the profits of the DBS operations constitute approximately 1 percent of The Coca-Cola Company's pre-tax profits and that it might be economically feasible for respondent Coca-Cola to operate its DBS on a break-even basis for an extended period of time, no evidence was adduced at the trial that respondent provides deep-pocket subsidies to its Chicago DBS or supports below-cost sales. As intervenors must fully appreciate, even independent bottlers sometimes operate unprofitably. (Tr. 1475). Evidence such as this hardly establishes the necessity for drastic ancillary divestiture relief. Nor are intervenors' other theories, analogizing this situation to vertical merger cases, supported by this record. See Brunswick Corp. v. Pueblo Bowl-O-Mart, ___ U.S. ___, 1977-1 Trade Cases, Para. 61,255; Elfman Motors, Inc. v. Chrysler Corp. 1977-2 Trade Cases, ¶ 61,650.

c. Request for Further Hearings on Relief

The bottlers further argue that a remand on issues of relief is necessary if their interests are to be adequately protected. Intervenors had fair notice that issues of relief were before the judge. Intervenors were afforded every opportunity to participate in the development of the trial record; they were authorized to offer documents into evidence, to call witnesses to testify in their behalf, and to examine or cross-examine witnesses called by respondents and complaint counsel. Along with the 26 bottlers, representing a cross section of the industry, seven executives of The Coca-Cola Co., the former President of Shasta Beverages, the Executive Vice-President of K-S Canning Corp., a contract canner, and two representatives of canned ice tea producers appeared at the trial. As the record shows, these witnesses addressed issues of relief as well as issues of liability; and intervenors' counsel, present at each hearing session, were free to pursue with these witnesses lines of inquiry relevant to questions of relief at intervenors' discretion. The fact that the record now fails to support intervenors' theories concerning the need for ancillary protection, in all respects, is no basis for concluding that a remand of this proceeding is either justified or necessary.

Several intervenors also request consolidated, industrywide hearings on relief. While this seems to assume the liability of other respondents in proceedings involving rule of reason inquiries, still pending before the administrative law judge, the contention that such hearings are necessary is otherwise lacking in merit. For even if we momentarily assume, for the sake of argument, the liability of respondents in proceedings before the judge, it would not necessarily follow that uniform, industrywide remedies or uniform ancillary relief would be necessary or appropriate. To the contrary, fact records different from the record here before us may well justify different remedial provisions. 87/ Under the circumstances,

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87/ We note that respondents have vigorously opposed consolidated industrywide hearings. (Opposition of Respondents to Motion For Consolidation, Dkt. Binder 8855, 1-3-1, filed August 12, 1971; See Order Denying Motion To Consolidate Proceedings, filed September 29, 1971).

we believe that a remand on issues of ancillary relief in consolidated, industrywide relief hearings is unwarranted and would unnecessarily delay final disposition of these cases.

C. National Environmental Policy Act (NEPA) Considerations

Finally, respondents contend that an Environmental Impact Statement (EIS) must be prepared by the Commission, pursuant to the National Environmental Policy Act (NEPA) (42 U.S.C. §4321 *et seq.*) before a final order is entered in this matter. Our rules provide that a formal EIS need not be filed in our adjudicatory proceedings. (16 CFR §1.82(d)). The issue has never been squarely before a court. 88/

At the trial, respondents called two experts on the ecological impact of beverage containers. These witnesses concluded that the returnable, refillable bottle may be an ecologically sound form of packaging. At two trips, for example, the refillable bottle has roughly the same impact on the environment (including water use, solid waste generation, air pollutants, water-borne wastes, and energy effluents) as the nonrefillable, nonreturnable bottle (TR. 3801, RX 126Z20-23); at four trips it has about the same impact as the conventional steel can (Tr. 3801); at five trips its impact is about that of an aluminum can which is recycled at an 80 percent rate. (Tr. 3802). Evidence also suggests that the refillable bottle with a trippage of 10 is more energy efficient than steel or aluminum cans or glass, nonrefillable bottles. 89/ Under certain circumstances, then, the returnable, refillable bottles may be ecologically superior to other package forms used by the bottlers.

88/ *See* Gifford-Hill & Co. v. F.T.C., 389 F. Supp. 167 (D.D.C. 1974) *aff'd* 523 F.2d 730 (D.C. Cir. 1975); Mobil Oil Corp. v. F.T.C., 1977-2 Trade Cases, ¶61,632. The Council on Environmental Quality, whose interpretation of statutory requirements under NEPA is entitled to great deference (Warm Springs Dam Task Force v. Gribble, 417 U.S. 1301, 1310 (1974); Jicarilla Apache Tribe v. Morton, 471 F.2d 1275 (9th Cir. 1973); Environmental Defense Fund v. Tennessee Valley Authority, 468 F.2d 1164, 1177-78, (6th Cir. 1972)), has concluded that the Commission's Rule 1.82(d), exempting adjudicatory proceedings from the EIS requirement, was consistent with NEPA. (Brief for Defendents-Appellees, Addendum, Gifford-Hill, *supra*.).

89/ Little evidence was adduced concerning the environmental impact associated with litter attributable to the use of one-way, throw-away containers.

We noted previously, however, that territorial restrictions on the use of returnable, refillable bottles will not, for reasons heretofore stated, be lifted by our order. As a result, a bottler will have even greater incentives than exist now to promote reusable bottle sales, since an increase in the intrabrand market share of this container will increase the bottler's soft drink volume protected by exclusivity. Nor would the "free rider" problem (See text at 32-35 supra) deter a bottler from actively promoting, as some have in the past, any economic and ecological benefits of the package in his territory. (RX 60, Tr. 2499). Use of refillable bottles is unlikely to change significantly as a result of the relief entered in this proceeding.

Beyond these observations based on the record compiled at the trial below, we note that NEPA was not designed to stymie the Commission's enforcement activities which seek to redress violation of the antitrust laws. Nor does NEPA, its legislative history, or its precedential case law require the preparation of a formal EIS in this proceeding. We find no basis for respondents' claim that these requirements apply to the adjudicatory activities of law enforcement agencies. 90/

90/ We note further that NEPA requires preparation of an EIS only in connection with "major Federal actions significantly affecting the quality of the human environment...." 42 U.S.C. §4332(2)(c). Based on our review of the record in light of that standard, we conclude that our order would not in any event require preparation of an EIS. Moreover, our decision, permitting respondents to continue their territorial restraints with respect to refillable bottles, is, we believe, less likely to have any effect on the use of this container than any resolution of this case other than allowing respondents to continue to restrain competition in violation of Section 5. NEPA, however, does not immunize respondents' unlawful activities, for environmental reasons, from the Commission's law enforcement processes.

VII. Consideration of the Dissenting Statement of Commissioner Clanton

In his dissenting statement, Commissioner Clanton recommends that this matter be remanded to the administrative law judge for hearings which would further explore the competitive effects of the challenged practice. The rationale which leads to this recommendation is, we believe, erroneous in two basic respects. First, it misapprehends complaint counsel's burden of proof. Second, it concludes that there is not enough evidence in the record to decide this case.

The dissent contends this case cannot be resolved without a full structural analysis of the soft drink syrup producing and bottling industries. 91/ (Dissent p. 2). At the bottling level where the restraint precludes intrabrand competition, the undertaking recommended would include surveys of each territory to determine (1) Coke's market share, (2) concentration trends over time, (3) barriers to new entry and barriers to effective competition, (4) the degree of product differentiation, and (5) market performance and profitability of fountain syrups. In addition, after further discovery, a "rigorous analysis" of profitability at the manufacturer and bottler levels would also be required. (Dissent p. 21). 92/ If, after examining the

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91/ It should be noted the territories imposed by PepsiCo, Inc., challenged in a companion matter, are not necessarily co-extensive with the territories of the Coca-Cola bottlers in the "corridor area" and arguably would have to be separately surveyed.

92/ Responding to a note in the Harvard Law Review, the dissent suggests that "the indicia for measuring market power are familiar concepts which do not present unmanageable problems of proof in a rule of reason case." (Dissent p. 20).

The burden of the inquiry proposed by the dissent should not be underestimated. We know from experience in merger cases involving one or two geographic markets and similar structural inquiries that such litigation is complex, extremely time-consuming, and burdensome to all parties.

In this instance, the trial would begin again from scratch, extensive pre-trial discovery would be required, and the structural characteristics both of the syrup industry and the bottling level in numerous territories, each the equivalent of a separate geographic market,would have to be surveyed and litigated. In all likelihood, years of costly trial would ensue; this, we believe, is unnecessary.

structural characteristics of numerous territories, it can be inferred that bottlers possess substantial market power, this might justify "striking down the restrictions irrespective of any countervailing benefits." (Dissent p. 10). 93/

The critical question raised by the dissenting opinion is whether complaint counsel, having demonstrated that respondents' vertical restraint adversely affects competition in the soft drink industry, were also required to adduce evidence showing the effect of the restraint on market shares and concentration, entry barriers, product differentiation, or the profits of the manufacturer and bottlers. We think not. 94/

We do not dispute, as the dissent suggests, that statistical data and market structure evidence might be relevant, and in some instances necessary, to determine the competitive effects of vertical restraints. Yet, the adverse effects of the restraints in this case have been established without such evidence. The

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93/ It should be noted that if it were established that a bottler had "substantial market power," the dissent would apply what is virtually a per se standard of illegality. It is unclear, however, whether this per se rule would prevent a new entrant, for example, at the syrup producing level, from offering exclusive territories in piggybacking situations to bottlers with market power. Whether market power evidence alone would be sufficient to meet the rigorous standards for applying a per se rule need not be decided.

94/ Economists sometimes use the terms "market power" and "monopoly power" interchangeably. See Scherer, Industrial Market Structure and Economic Performance (1970) at 10. The dissent notes that "The Commission determined correctly that proof of monopoly power or unrestricted market power, as argued by respondents, is an unnecessary prerequisite to a finding that a particular restraint is unreasonable." (Dissent p. 14).

In recommending a remand to adduce market power evidence, it is unclear whether the focus would be to determine the bottlers' market power in light of all the brands they may piggyback or just the Coca-Cola brand. (The dissent's analysis of the effect of piggybacking on entry barriers at the syrup-producing level, which we previously noted, supra at 49, fn. 45, is entirely consistent with our conclusion that piggybacking also tends to concentrate brands at the bottling level.) This is important because the focus of the remand sought by the dissent seems to be limited to a determination of the market power of Coca-Cola. Yet this would ignore the fact that piggybacking tends to concentrate brands and the power to price piggybacked brands in the hands of the strongest bottlers in a territory.

record demonstrates that respondents' territorial policy (1) impedes competition in the types of delivery services bottlers offer to their customers 95/, (2) prevents efficient bottlers from fully exploiting their competitive advantages, and (3) prevents retailers located within the territories of less efficient bottlers from purchasing Coca-Cola and allied products from efficient sources of supply. Moreover, the record leaves little doubt that the practice substantially lessens both intrabrand and interbrand price competition. The testimony of the President of The Coca-Cola Company, other officials of the company, and bottlers, which virtually constitutes admissions of substantial adverse competitive effects, clearly supports these findings. 96/

Such anticompetitive effects have indeed been inferred in cases where the evidence was much less direct than it is here. Relying on U.S. v. Continental Can Company, 378 U.S. 441 (1964), the Commission recently noted that concentration and market share data alone suffice to establish illegality of a merger in the absence of convincing proof to the contrary. Jim Walter Corp., Dkt. No. 8986, issued December 20, 1977. The evidence in this record that respondents' practice substantially lessens price competition is, we believe, more compelling than would be the case if such effect were inferred from concentration and market share data alone. The dissent, moreover, would require a more detailed evaluation of pricing patterns in the industry. As we recently noted, however, "The absence of discernible effect on pricing or the lack of small company failures attributable to a merger can be given little weight.... At best, such effects are difficult to measure, particularly if prices are already at non-competitive levels." 97/ Adverse effect on price is, however,

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95/ The reservations expressed in the dissent about the demand for central warehousing would certainly surprise the witnesses who testified in this proceeding. While the pros and cons of this method of distribution were hotly contested, the demand for the service was never seriously disputed. (RPF 88-91, Ans. Br. 55).

96/ The dissent without elaboration would dismiss, as "anecdotal" testimony reflecting the adverse effects of the practice provided by these witnesses in response to questioning by the judge and by counsel. We are unable to depreciate such testimony in this manner. (See Text at 27 fn. 28; 47-52 *supra*.)

97/ Jim Walter Corp., *supra*.

clearly discernible in this record. Similarly, evidence, which the dissent would require, showing whether new entrants have made inroads into the various territories would be of limited utility in rebutting the evidence of anticompetitive effect reflected in the record. 98/

As we mentioned, a prima facie case was established through the testimony of the President of The Coca-Cola Company and other industry witnesses. Thus as Commissioner Clanton, writing for a unanimous Commission in the Jim Walter case, correctly observed, it is respondent's burden, once a prima facie case has been established based upon other evidence of anticompetitive effect, to provide exculpatory evidence "pertaining to the structure, history, and probable future of the asphalt and tar roofing industry sufficient to overcome the presumption (arising from concentration and market share data alone) that the merger threatens a substantial lessening of competition." (Jim Walter Corp., supra at 42, et seq.). In this instance, we believe it was unnecessary for complaint counsel to resort to further statistical data to confirm the testimony upon which a prima facie violation of Section 5 had been established, and to the extent such data may have been relevant to the defense, it was respondents' burden to adduce it.

We agree with the dissent that "... one's preference for one kind of competition over another (price competition v. nonprice competition) should not automatically condemn" respondents' practice, although we believe that emphasis on the tendency of respondents' practice to impede price competition

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98/ Id. at 45-46. As we stated in RSR Corp., 88 FTC 797 (1976):

> even proof of low entry barriers ... can be at most of slight exculpatory value in the face of probable anticompetitive effects, since all it suggests is that such effects may be smaller or short lived, not that they are unlikely to occur. (at 289).

Furthermore, Jim Walter clearly indicates that the burden of proof rests with respondent to show whether "new firms have eroded the market position of the industry leaders." (Supra at 46).

is not misplaced. A practice which lessens price competition touches the core of the free enterprise system. The Supreme Court has described the price mechanism as "critical" and "sensitive." U.S. v. Container Corp. of America, 1969 Trade Cases at 86,413. In U.S. v. Socony-Vacuum Oil Co., Inc., the court, citing Handler, Federal Antitrust Laws--A Symposium (1931), noted that this aspect of competition is "the central nervous system of the economy." Thus the alleged justifications for a practice which substantially lessens price competition requires, and in this instance has received, the closest scrutiny. 99/

99/ It is likely that the recommended surveys of various territories might disclose that some bottlers have "substantial market power" while others may not, and it is unclear what outcome the dissent would regard as appropriate in these circumstances. If a certain percentage of the bottlers surveyed possessed "substantial market power," would this justify striking down the restraint as it applies to the others "irrespective of any countervailing benefits?" If not, would the restraint be illegal only when it applies to bottlers with "substantial market power?" The surveys called for by the dissent might reveal, for example, that Coca-Cola bottler A has "substantial market power," but not Coca-Cola bottler B. Would the restriction then be lawful as applied to bottler B and unlawful as to bottler A? This would leave bottler A with "substantial market power" free to compete while bottler B would remain restrained. Yet in order to dissipate the power of bottler A presumably bottler B should be free to compete in bottler A's territory.

If the dissent is concerned about the restriction only when it serves to "protect" bottlers with "substantial market power," then it would seem to follow that a bottler without such power might remain protected from intrabrand competition in his territory, since the dissent's per se rule based on market power might not apply to him. He would, however, apparently be free to compete in the territory of a bottler with market power, at least until intrabrand competition dissipates that power. Once the power has been dissipated, the market power per se rule would no longer apply, and the restraint might again be lawful as it would presumably be for similarly situated bottlers who were found not to possess market power. It might then be necessary to monitor each bottler's power periodically to determine when, where, and how long intrabrand competition might be needed to prevent the build-up of "excessive market power."

The dissent reexamines these justifications and raises a number of questions concerning whether investments by bottlers operating in exclusive territories enhance or impair competition, whether exclusive territories facilitate interbrand competition by enhancing availability 100/ and by inducing greater demand for soft drink products, whether territorial restrictions facilitate advertising by the bottlers which promotes interbrand competition, and whether obstructions to intrabrand competition are necessary to maintain product quality. The issues now raised in the dissent, concerning which it finds the record inadequate, were previously raised by respondents in the form of affirmative arguments in justification of these restraints. In each instance, the evidence respondents relied upon in support of their contentions that the restrictions were reasonably necessary to maintain at current levels the interbrand viability of Coca-Cola and allied products were carefully examined by the Commission and found wanting. 101/

Thus the dissent reviews the alleged relationship between the restraint, capital formation, and interbrand competition, and is apparently unable to conclude from the record that investments in exclusive territories enhance interbrand competition, are necessary to the continued competitive viability of Coca-Cola and the allied product, or that respondents' capital formation arguments, and the evidence relating to them, justify the restraint. (Dissent at 7). If the burden rests with respondents to establish this defense, as we believe it does 102/ the dissent seems to confirm our finding that respondents have not, in this respect, adequately justified their restraint.

The dissent also examines respondents' arguments to the effect that exclusive territories facilitate level pricing by the bottlers and thus "intrabrand competition by enhancing

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100/ As we noted previously, it is not possible on this record to state definitively that exclusive territories enhance output to a greater degree than would lower prices resulting from intrabrand competition. (Text at 31, fn. 31, *supra*).

101/ The dissent, while coming close to accepting respondents' arguments that restraint promotes interbrand competition, does not actually do so. (Dissent at 12).

102/ *Sandura*, *supra*; *Snap-On Tools*, *supra*; *Jim Walter*, *supra*.

availability." While it is apparently not disputed that market penetration based on level pricing results in price discrimination which "means ... that some Coca-Cola is provided at less than its actual cost and some is priced above" it is suggested that the cost differentials may not be substantial enough to warrant price differences (Dissent at 9) and that accounting and billing costs may exceed cost differentials or may not justify an expanded price list. 103/ Such assumptions, while perhaps a plausible rationale for level pricing in some instances, are largely contrary to evidence cited in this opinion and elsewhere in the dissent. (See Dissent at 14, fn. 27). 104/ If prices more accurately reflected actual costs as a result of intrabrand competition, efficient retailers would be in a position to pass any cost savings on to consumers. Under the present system, however, level pricing deprives efficient retailers and their customers of the benefits of such competitive options. 105/ Thus the dissent does not seem to resolve the issue of whether respondents have adequately justified the restraint because it aids market penetration by permitting level pricing.

The same is true of respondents' advertising and "free-rider" arguments. Judgments concerning the nature of the advertising for Coca-Cola were based on a thorough review of the advertising respondents or bottlers elected to introduce into the record. We certainly do not believe complaint counsel were obligated to provide the evidence upon which a more "systematic and thorough review of Coke advertising" might have been made. (Dissent at 10). Nor do we believe complaint counsel can reasonably be expected to offer evidence showing both the efficiency of the promotional methods respondents now employ and "the relative efficiency of manufacturer (and presumably retailer) advertising versus bottler advertising." (Dissent at 10).

103/ The same analysis might also hold true even if the bottlers have "substantial market power."

104/ Yet even if bookkeeping costs justified the continuation of level pricing, the evidence shows that some bottlers are more efficient than others. Thus the level price of some bottlers is likely to be lower or more competitive than the level price charged by others.

105/ With respect to brand availability, the dissent does not contend that if a demand exists for these products at prices which reflect actual costs, the market is unlikely to supply them at competitive prices.

The court in GTE was concerned that the Schwinn rule declaring exclusive territories per se illegal might result in "a shift to less efficient methods of obtaining the same promotional effects." (GTE, supra at 71,901, fn. 25). In applying the rule of reason to these restraints, the court thus opened for further inquiry, on a case-by-case basis, the possibility that promotional methods employed in exclusive territories may be more efficient than alternative promotional methods absent the restraint. The court did not hold, however, that the mere assertion of such efficiency by a respondent without supporting facts was enough to require what the dissent acknowledges to be the "very difficult" process of exploring the "relative efficiency" of alternative methods available in unrestricted markets.

The dissent renders no judgment either about the efficiency of the promotional methods respondents now employ or about the promotional effects they obtain. 106/ This is not surprising since respondents did not, in asserting this defense, adduce evidence which would allow such judgments to be made. Consequently, even if complaint counsel had produced evidence of the efficiency of alternative methods of promotion, respondents' failure to establish the efficiency of their own methods would have made, as noted in the dissent,"fine-tuned assessments" of relative efficiency very difficult.

The dissent's consideration of respondents' quality-control justifications focuses only upon the alleged relationship between territorial restrictions and quality control in distribution. 107/ The issue here seems to be whether the

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106/ The dissent notes that one such effect might be that the promotion of the Coke brand has conferred substantial market power upon respondents and their bottlers by successfully differentiating their product, but neither this nor any other brand-enhancement effect can be measured based on the evidence in this record. The dissent does not otherwise dispute our analysis which shows that the "free-rider" problem is unlikely to reduce the bottlers' incentives to advertise desirable information about price, quality, and services to their customers. (GTE, supra at fn. 25; text at 33-34, supra).

107/ The relationship between territorial restrictions and quality control in manufacturing is not considered in the dissent.

Commission may independently evaluate the alleged quality-control justification to determine "...whether , assuming some justification for the limitation can be shown, their operation is reasonably related to the needs which brought them into being." White Motor Co., supra, 372 U.S. 253, 271 (1973) (Brennan, J. concurring).

According to the dissent, any effort to determine whether the restriction is excessively restrictive "implicitly second-guesses Coke's belief that obstructions to intrabrand competition are needed to maintain the high quality of its product." (Dissent at 12). The situation is the same, though the reverse of the problem considered by the Third Circuit in American Motors, supra. In American Motors, the court was concerned that plaintiff's lawyers, in a private treble damage action under the Sherman Act, might "conjure up some method of achieving the business purpose in question which would result in a somewhat lesser restriction of trade." Our concern here is in protecting the public interest against the imaginations of entrepreneurs and lawyers who are students of antitrust practice and skillful advocates in defending trade-restrictive conduct. This requires us to assess the competitive effects of respondents' action. 108/ The Commission is not bound to accept Coke's belief that obstructions to intrabrand competition are needed when the consequences of its action are excessively trade-restrictive. 109/ Further, respondents did not substantiate, and there is really no basis on this record for measuring, the efficiency of territorial restrictions, including, for example, the costs associated with policing and enforcing them, as a quality-control monitoring mechanism. Thus it is unclear whether alternatives, such as an open dating system which might allow the market to monitor product age, would be "less efficient." 110/

108/ Certainly no firm is omniscient. The Coca-Cola Co., for example, (1) doubted that carbonated soft drinks could be bottled successfully and sold for home consumption (See Text 10 fn. 12 supra; RPF 28) and (2) agreed to sell its syrup at a set price, in perpetuity, without provision for market conditions which might increase the cost of the ingredients used to make the syrup (See The Coca-Cola Bottling Co. v. The Coca-Cola Co. supra).

109/ See Coors, supra. While the combination of price fixing, territorial restrictions, and customer restrictions were found to be per se illegal in Coors, the Commission nevertheless fully considered and found merit in some of the quality-control arguments advanced by Coors.

110/ The dissent invokes what seems to be a "rule-of-plausibility" which would virtually end the evaluation of an alleged justification upon the assertion by a respondent of a plausible link between the restraint and some legitimate business purpose.

Under these circumstances, the language of the Supreme Court in Northern Pacific Ry.Co., noted earlier in this opinion, is appropriate here. The court in that case emphasized that the antitrust laws rest:

> ... on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition. Northern Pacific Ry. Co., supra.

Conclusion

Other arguments of the parties, intervenors and amici not specifically addressed in this opinion have been considered and found to be without merit. Having reviewed the record in its entirety, and all of the arguments advanced by respondents in support of these restraints, and having found no adequate justification for the substantial adverse affects these restraints are having on competition in this industry, we conclude that territorial restrictions on the sale of finished Coca-Cola and allied soft drink products are unreasonable restraints on trade, and constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act.

An appropriate order is attached.

APPENDIX 5

United States Department of Justice

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

WASHINGTON, D.C. 20530

OCT 15 1979

RECEIVED

OCT 15 1979

Honorable Peter W. Rodino, Jr.
Chairman, Committee on the Judiciary
House of Representatives
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your request for the views of the Department of Justice on H.R. 3567, the "Soft Drink Interbrand Competition Act." This bill would establish a new standard for the legality of exclusive territorial arrangements used in the distribution or sale of a trademarked soft drink product. It would also eliminate damage liability for any such arrangement unless the defendants continued to use it after a final adjudication of its illegality.

This bill is one of the most recent of a series of bills introduced in the last few years that would modify for the soft drink industry the normal antitrust rules concerning exclusive territories. The Department of Justice opposed the passage of those earlier bills. In our letter of June 4, 1979, to Chairman Metzenbaum of the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary, we recommended against enactment of S. 598, which is substantively identical to H.R. 3567, and we have also recommended against enactment of other bills currently pending before the House of Representatives designed to establish special standards for the soft drink industry. The Department of Justice continues to oppose this kind of special interest legislation.

In recent years, Congress has consistently refused to narrow the application of antitrust law by creating special exemptions. Indeed, far from being favorably disposed to narrowing its application, Congress has exhibited in the past few years an increasing commitment to strengthening the enforcement of antitrust law. In this context, the continuing attempt by some industries to obtain special treatment under the antitrust laws must be viewed with great skepticism. As the National Commission to Review Antitrust Laws and Procedures recently concluded, proponents of any form of antitrust immunity should have the burden of overcoming a strong

presumption against such immunities by producing clear and convincing factual evidence that the characteristics of a particular industry make the application of usual antitrust standards unwarranted. 1/ In our opinion, this burden has not been satisfied by the proponents of legislation such as H.R. 3567.

Section 2 of H.R. 3567 would provide that territorial agreements in any trademark licensing contract or agreement involving soft drink manufacturers, distributors, and sellers are legal under the antitrust laws provided that the products covered by such agreements are in "substantial and effective competition with other products of the same general class." We believe that this proposed modification of the current legal standard would introduce an unnecessary and uncertain element into the law of vertical restraints, and would unfairly tip the scales in favor of the soft drink industry at the expense of the consuming public.

Under a recent Supreme Court decision, 2/ vertical non-price restraints between a manufacturer and its distributors or sellers, including territorial arrangements, are tested under the rule of reason to determine whether, under all the circumstances of the case, they constitute a reasonable or an unreasonable restraint of trade. The Supreme Court left open the possibility that particular applications of vertical restrictions might be held illegal *per se* under the antitrust laws, but only upon a showing of a demonstrable anticompetitive economic effect. 3/ The Federal Trade Commission has applied this rule of reason analysis in a proceeding under Section 5 of the FTC Act involving vertical restraints in the soft drink industry. 4/ Thus, existing law permits soft drink

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1/ Report of the National Commission for the Review of Antitrust Laws and Procedures, 186-87 (1979).

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

3/ *Id.* at 58-59.

4/ *The Coca-Cola Co.*, 91 F.T.C. 517, 615-16 (1978), *appeal docketed*, No. 78-1364 (D.C. Cir. April 24, 1978). This bill, if enacted, would alter the precise legal standard under which the *Coca-Cola* case was decided, and thus the case, now

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manufacturers and bottlers to present any claimed economic justification for a particular territorial restriction.

In light of present case law on vertical restraints there does not appear to us to be any justification for this proposed legislation. H.R. 3567 would replace the comprehensive rule of reason analysis, which allows consideration of all of the circumstances and is designed to determine whether on balance a restraint is anticompetitive, with an approach which focuses exclusively on the existence of interbrand competition. There is no reason to believe that this approach distinguishes between procompetitive and anticompetitive vertical restraints with greater precision than the existing antitrust standard applicable to all vertical restraints. Under existing law, the courts place great weight on the vigor of interbrand competition, which the Supreme Court called "the primary concern of antitrust law." 5/ The Federal Trade Commission carefully considered the vigor of interbrand competition in its decision concerning vertical restraints in the soft drink industry. 6/ We perceive no significant advantage in adopting a standard which excludes all other factors from consideration, especially since the proposed standard is of uncertain meaning and scope. 7/

4/ (Cont'd) on appeal, would probably have to be at least partially relitigated under the standards set forth in this legislation. It would be inappropriate for the Department of Justice to comment on the merits of a case currently on appeal. We do note that the FTC conducted a lengthy and thorough inquiry, affording representatives of the soft drink industry ample opportunity to present any relevant evidence in support of their position, and that the United States Court of Appeals for the District of Columbia Circuit has heard argument on the case, which is now awaiting decision. We believe that the normal administrative and judicial process should be allowed to run its course, and that congressional action at this time would be premature.

5/ Continental T.V., Inc. v. GTE Sylvania Inc., supra, at 52 n.19.

6/ The Coca-Cola Co., supra, 91 F.T.C. at 634-44.

7/ A somewhat similar standard to the "substantial and effective" standard of this bill was employed in the "fair trade" legislation repealed by the Consumer Pricing Act of

The risks inherent in a standard which permits vertical restraints whenever there is substantial interbrand competition are real and substantial. Most of the arguments suggested in favor of vertical restrictions are based on an asserted need to assure bottlers of greater revenues by insulating them from intrabrand competition. These additional revenues, proponents claim, would benefit consumers by allowing bottlers to make greater capital investments and to provide superior products and service. Such claimed benefits would accrue, however, only if consumers were denied the benefits of competition -- lower prices and the opportunity to choose among competing suppliers. Moreover, there is no guarantee that bottlers would voluntarily devote any of their artificially inflated revenues to providing consumer benefits that would not be profitable under a system of free competition. Nor is there any assurance that bottlers would perform as efficiently or innovate as readily in such areas as service and packaging without the spur of intrabrand competition. Normally consumers will pay for the services and products they desire and, absent special circumstances, they should not be forced to pay higher prices for services they would prefer to forego. As the National Commission for the Review of Antitrust Laws and Procedures has recently concluded, free and open competition is generally the surest guarantee of consumer welfare. 8/

7/ (Cont'd) 1975, Pub. L. No. 94-145, 89 Stat. 810. The Miller-Tydings and McGuire Acts, which legalized resale price maintenance sanctioned by state law, limited the resale price maintenance authorizations to products that were in "free and open competion with commodities of the same general class." The courts interpreted the "free and open" competition standard very broadly to include all circumstances where another product existed that consumers purchased for the same purpose as the product subject to the resale price maintenance agreement. *See* Bowen v. New York News, Inc., 366 F. Supp. 651, 661-62 (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 vagueness and unworkability of the "free and open" standard was strongly criticized. Herman, "Free and Open Competition", 9 Stan. L. Rev. 323, 327-32 (1957). The protection afforded by the "substantial and effective" standard which this bill would apply to territorial restrictions in the soft drink industry may be equally illusory.

8/ Report of the National Commission for the Review of Antitrust Laws and Procedures, *supra,* at 177-189.

The Department of Justice recognizes that many proponents of legislation to legalize territorial restrictions in the soft drink industry are motivated by a desire to encourage the use of returnable bottles, in order to conserve energy and protect the environment. H.R. 3567, however, contains no provision which requires, or even encourages, bottlers to use returnable bottles. This proposed legislation offers bottlers and manufacturers immunity from the antitrust laws for their vertical territorial agreements whether or not they make any effort to offer returnable bottles. Special legislation may be necessary where the market process is not fully able to take into account the total costs imposed on society by the sale of particular commodities, as in the case of environmental or safety hazards. Such legislation, however, should deal directly with the problem. Affording manufacturers and bottlers an unrestricted license to eliminate intrabrand competition in the hope that some of them may voluntarily choose to offer returnable bottles is not an efficient solution to energy or environmental problems.

The Department of Justice agrees with proponents of H.R. 3567 that nonprice vertical restraints may in some circumstances foster competition by helping small but highly efficient and aggressive firms to enter the market and compete effectively. 9/ Current law does in fact recognize that vertical restraints may have these positive effects, and it takes them fully into account in evaluating the overall legality of a particular restraint. Current law also recognizes, as H.R. 3567 does not, that manufacturers can often achieve these benefits without completely eliminating intrabrand competition. H.R. 3567, however, would legalize the most extreme form of territorial restraint, the categorical prohibition on sales outside the assigned area, even when only a more limited restraint would be justified in the circumstances of a particular case. In many instances, we believe, less restrictive arrangements, such as area of primary responsibility clauses designed to encourage effective market penetration, would offer ample protection for the industry's legitimate needs. H.R. 3567 thus affords bottlers and manufacturers a license completely

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8/ Report of the National Commission for the Review of Antitrust Laws and Procedures, *supra*, at 177-189.

9/ See, *e.g.*, Continental T.V. v. GTE Sylvania, Inc, *supra*, at 54-57.

to deprive consumers of the benefits of intrabrand competition even where less restrictive measures would suffice.

Moreover, to the extent this bill may be interpreted as applying to licensing agreements between competing manufacturers, distributors or sellers of soft drinks, it would substitute the vague protection of the "substantial and effective competition" standard for the current presumption against horizontal market division agreements. 10/ Existing law takes account of the special dangers they present, but does not bar consideration of special economic justifications for certain territorial agreements among competitors. 11/

In sum, the standard of legality incorporated in H.R. 3567 would unfairly tip the scales in favor of the soft drink industry. Current law strikes a fair balance between the need for an orderly and efficient marketing system and the benefits of robust and uninhibited competition. Private plaintiffs, the FTC, and the Department of Justice now must bear the burden of proving that a particular vertical territorial restraint is unreasonable under the circumstances. H.R. 3567 would make that burden even heavier by creating a new and vague standard for illegality without any showing that the current standard is deficient. Congress has refused in previous years to impose higher prices on consumers for the benefit of the soft drink industry, and it should continue to do so.

H.R. 3567 also would remove the possible damage liability of any soft drink manufacturer or bottler who enters into territorial restrictions later determined to be illegal. Section 3 of H.R. 3567 provides that the existence or

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10/ In United States v. Topco Associates, Inc., 405 U.S. 596 (1972), competing distributors who jointly owned a trademark agreed among themselves to allocate exclusive territories for sales of the trademarked goods, and the Supreme Court held this horizontal division of markets illegal *per se* under the Sherman Act.

11/ See the final lower court order in *Topco*, accepted by the Supreme Court, which permitted such arrangements as "areas of primary responsibility." United States v. Topco Associates, Inc., 1973-1 Trade Cas. ¶ 74,391 (order) and ¶ 74,485 (amendment and opinion) (N.D. Ill. 1973), *aff'd.*, 414 U.S. 801 (1973).

enforcement of such territorial agreements "prior to any final determination that [they] are unlawful shall not be the basis for recovery under section 4" of the Clayton Act. Section 4 of the Clayton Act imposes treble damage liability on persons that violate the antitrust laws. Under this provision victims would be prevented from recovering damages for their actual injuries, much less treble damages, even if soft drink manufacturers or bottlers not faced with substantial and effective interbrand competition agreed to territorial restrictions for the sole purpose of restraining competition and raising prices, unless the defendants continued to use the restrictions after the specific agreements had been determined to be illegal. Even then any recovery would appear to be limited to damages inflicted after the adjudication of illegality. The practical effect of this limitation would be virtual immunity from any damage liability for anticompetitive and unjustified territorial restrictions in this industry. By restricting damage liability so drastically even for vertical restraints illegal under the modified standard of section of H.R. 3567, section 3 would defeat both the compensatory and the deterrent functions of private damage actions under the antitrust laws. The implicit limitation of relief to injunctions against the continuation of illegal restraints deprives the victims of these conspiracies of the monetary incentive to sue which has long been recognized by the Congress as necessary for effective private enforcement of these laws. We see no justification for a provision which would cripple private enforcement in this manner.

Proponents of H.R. 3567 claim that it would be unfair to subject the soft drink industry to possible treble damage liability because of authority suggesting territorial agreements in this industry were legal. For example, proponents point to Coca-Cola Bottling Co. v. Coca-Cola Co., 269 F. 796, 813-14 (D. Del. 1920), wherein the district court held certain territorial restrictions to be legal in the context of an attempt by Coca-Cola to void one of its own contracts as contrary to law. However, it would be unjustified for the defendants in any of these cases, much less for other members of the industry, to rely in perpetuity on such authority for the absolute legality both of types of restrictions that were the subject of litigation and of other types as well. As the industry is well aware, the legal standards under which those cases were decided have been modified over the years, 12/

12/ See, e.g., United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), overruled by Continental T.V., Inc v. GTE Sylvania Inc., supra.

and changing conditions may alter the effect of territorial restrictions on competition from what it was when those cases were decided. 13/ Proponents of the legislation have shown no surprise or unfairness that justifies singling out the soft drink industry for the damage immunity which H.R. 3567 would create.

We can see no reason to modify for a particular industry the already extremely flexible law on exclusive territories. Such a move can only encourage other industries to demand equal treatment. H.R. 3567 does not represent a constructive attempt to clarify the law on exclusive territories. It represents an effort by special interests to remove themselves from the application of antitrust rules designed to maximize competition and preserve efficiency. The Department of Justice recommends against enactment of this legislation.

The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

Alan A. Parker
Assistant Attorney General

13/ In this connection, it is important that any damage liability would be limited to the period of time which a territorial restriction was proven unreasonably to restrain trade.

United States Department of Justice

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

WASHINGTON, D.C. 20530

16 JAN 1980

Honorable Peter W. Rodino
Chairman, Committee on
the Judiciary
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Department of Justice would like to express its views on H.R. 5818, the "Small Business Soft Drink Energy Conservation and Interbrand Competition Act." This bill would establish a new standard for the legality of exclusive territorial arrangements used in the distribution or sale of a trademarked soft drink product.

This bill is one of the most recent of a series of bills introduced in the last few years that would modify for the soft drink industry the normal antitrust rules concerning exclusive territories. The Department of Justice opposed the passage of such bills introduced in previous Congresses. In our letter to Chairman Staggers of the Committee on Interstate and Foreign Commerce of August 15, 1979, we recommended against a pending bill, H.R. 3573, which would establish a standard of legality substantively identical to the standard of H.R. 5818. We have also recommended against enactment of other pending bills designed to establish special standards for the soft drink industry. 1/ The Department of Justice continues to oppose this kind of special interest legislation.

1/ In a letter of June 4, 1979, to Chairman Metzenbaum of the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary, we recommended against enactment of S. 598. Richard J. Favretto, Deputy Assistant Attorney General, Antitrust Division, testified before the Subcommittee in opposition to S. 598 on September 26, 1979. The Department of Justice recommended against enactment of H.R. 3567 in its October 15, 1979 letter to you. On October 24, 1979, Deputy Assistant Attorney General Favretto testified in opposition to H.R. 3567 and H.R. 3573 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary. In letters to Chairman Staggers of July 3, October 15, and December 12, 1979, we have recommended against enactment of H.R. 1611, H.R. 1224, H.R. 4266, and H.R. 4621.

In recent years Congress consistently has refused to narrow the application of antitrust law by creating special antitrust exemptions. Indeed, far from being favorably disposed to narrowing the application of antitrust law, Congress has exhibited an increasing commitment to strengthening the enforcement of antitrust law. In this context, the continuing attempt by some industries to obtain special treatment under the antitrust laws must be viewed with great skepticism. As the National Commission to Review Antitrust Laws and Procedures recently concluded, proponents of any form of antitrust immunity should have the burden of overcoming a strong presumption against such immunities by producing clear and convincing factual evidence that the characteristics of a particular industry make the application of usual antitrust standards unwarranted. 2/ In our opinion, this burden has not been satisfied by the proponents of legislation such as H.R. 5818.

Section 1 of H.R. 5818 would amend the Small Business Investment Act by adding new sections 801-804. The proposed section 803 of the Small Business Investment Act would provide that exclusive territorial agreements in any trademark licensing agreement involving soft drink manufacturers, distributors, and sellers are legal under the antitrust laws unless it is established that (1) other competing products of the same general class are "not generally available to consumers" in the relevant territory and (2) elimination of the territorial agreement would not (A) adversely affect the quality of the environment, (B) significantly increase energy consumption, (C) increase the cost of soft drinks in any section of the country, or (D) lead to concentration of economic power in the soft drink industry. The Department of Justice believes that the immunity afforded the soft drink industry by this provision would unfairly deny the consuming public the protection of the antitrust laws. 3/

2/ Report of the National Commission for the Review of Antitrust Laws and Procedures 186-87 (1979).

3/ The proposed amendments to the Small Business Investment Act also include a new section 804, requiring the Department of Justice and the Federal Trade Commission to consult with the Small Business Administration "prior to any action assumed" pursuant to the proposed section 803. Section 2 of H.R. 5818 would require the Chief Counsel for Advocacy of the Small Business Administration to submit a report to the President and the Congress concerning the implementation of the bill and its effects on small businesses in the soft drink industry. Section 3 of H.R. 5818 would provide that the legislation shall apply to pending cases.

The Supreme Court has held that vertical nonprice restraints agreed upon by a manufacturer and its distributors or sellers, including territorial arrangements, are tested under the rule of reason to determine whether, under all the circumstances of the case, they constitute a reasonable or an unreasonable restraint of trade. 4/ The Supreme Court left open the possibility that particular applications of vertical restrictions might be held illegal *per se* under the antitrust laws, but only upon a showing of a demonstrable anticompetitive economic effect. 5/ The Federal Trade Commission has applied this rule of reason analysis in a proceeding under section 5 of the FTC Act involving vertical restraints in the soft drink industry. 6/ Thus, existing law permits soft drink manufacturers and bottlers to present any claimed economic justification for a particular territorial restriction.

H.R. 5818 would alter substantially this reasonable balance between the need for an efficient marketing system and the benefits afforded the consumer by robust and uninhibited competition. Like most of the other pending bills that would grant the soft drink industry a special antitrust exemption, H.R. 5818 would replace the rule of reason analysis, which allows consideration of all of the circumstances, with a rule focusing on the existence of interbrand competition. Existing law, however, takes fully into account the existence of interbrand competition. Under the rule of reason analysis, the courts place great weight on the vigor of interbrand competition in assessing the anticompetitive effect of

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

5/ *Id.* at 38-59.

6/ *The Coca-Cola Co.*, 91 F.T.C. 517, 615-16 (1978), *appeal docketed*, No. 78-1364 (D.C. Cir. April 24, 1978). H.R. 5818, if enacted, would alter the precise legal standard under which the *Coca-Cola* case was decided, and thus the case, now on appeal, would probably have to be at least partially relitigated under the standards set forth in this legislation. It would be inappropriate for the Department of Justice to comment on the merits of a case currently on appeal. We do note that the FTC conducted a lengthy and thorough inquiry, affording representatives of the soft drink industry ample opportunity to present any relevant evidence in support of their position, and that the United States Court of Appeals for the District of Columbia Circuit has heard argument on the case, which is now awaiting decision. We believe that the normal administrative and judicial process should be allowed to run its course, and that congressional action at this time would be premature.

particular vertical restraints. 7/ We perceive no justification for abandoning existing law, which requires the courts to determine whether on balance the particular restriction is unreasonable, in favor of a standard which would preclude consideration of any factor except the existence of interbrand competition.

Furthermore, while purporting to condition immunity on the existence of interbrand competition, the standard of H.R. 5818 is so weak that it apparently immunizes vertical territorial restraints even if interbrand competition in the territory is not significant. Proposed section 803(1) would establish a rigid rule immunizing vertical territorial restraints in the soft drink industry whenever a product of the "same general class" is "generally available." This standard apparently includes no requirement that the competing product account for a significant share of sales in the territory, nor does it otherwise guarantee that the antitrust exemption will be available only where a competing product exerts substantial competitive pressure. Thus, H.R. 5818 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." Moreover, the vague term "same general class" may be interpreted to include products that are not, in any realistic sense, substitutes. 8/ Thus, the standard of H.R. 5818 would not even guarantee that there would be meaningful interbrand competition in every situation where the exemption was available.

7/ The Supreme Court has called interbrand competition "the primary concern of antitrust laws." See Continental T.V., Inc., v. GTE Sylvania, Inc., supra at 52 n.19. The Federal Trade Commission carefully considered the vigor of interbrand competition in its decision concerning vertical restraints in the soft drink industry. The Coca-Cola Co., supra, 91 F.T.C. at 634-44.

8/ The standard of H.R. 5818 contrasts with the "substantial and effective" competition standard of other pending bills, such as H.R. 3567, H.R. 1611, H.R. 1224, and H.R. 4621. As we have noted in our letters opposing those bills, experience suggests that even statutory language requiring that the competition be "substantial and effective" may not afford the consumer very much protection. A somewhat similar standard was used in the "fair trade" legislation repealed by the Consumer Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 810. The Miller-Tydings and McGuire Acts, which legalized resale price maintenance sanctioned by state law, limited the resale price maintenance authorization to products that were in "free and open competition with commodities of the same general class." The courts interpeted the "free and open competition" standard very broadly to include all circumstances where another product existed that consumers purchased for the same purpose as the product subject to the resale price maintenance

A special standard legalizing vertical territorial restraints in the soft drink industry whenever a product of the same general class is generally available poses a substantial threat to consumer welfare. Proponents of legislation to legalize territorial restraints in the soft drink industry often claim that insulating bottlers from intrabrand competition will benefit the consumer by permitting bottlers to make greater capital investments and to provide superior products and service. These claimed benefits, however, will accrue only if the consumer is denied the benefits of competition -- lower prices and the opportunity to choose among competing suppliers. There is no guarantee that bottlers will voluntarily devote any portion of the increased revenues derived from the elimination of intrabrand competition to providing consumer benefits that would not be profitable under a system of free competition. It is particularly unlikely that bottlers would use these surplus profits for these purposes if they were facing only minimal interbrand competition, and thus had little incentive to serve their customers better. Moreover, consumers will normally pay for the services and products they desire. Absent special circumstances, they should not be forced to pay higher prices for services they would prefer to forego. Nor is there any assurance that bottlers will perform as efficiently and innovate as readily in such areas as service and packaging without the spur of intrabrand competition. As the National Commission for the Review of Antitrust Laws and Procedures recently concluded, strong and unrestrained competition is generally the surest guarantee of consumer welfare. 9/

The Department of Justice recognizes that vertical territorial arrangements may not always have the effect of decreasing competition. As the Supreme Court has recognized, vertical non-price restraints may in some circumstances enhance competition by helping small but efficient and aggressive firms to enter the market and compete effectively. 10/ Current law takes such

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8/ [Contd] agreement. See Bowen v. New York News, Inc., 366 F. Supp. 651, 661-62 (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 "free and open" standard was inadequate because of its vagueness and openendedness. Herman, "Free and Open Competition", 9 Stan. L. Rev. 323, 327-32 (1957). Thus, the protection afforded even by express statutory language designed to ensure that interbrand competition is vigorous may prove to be illusory. H.R. 5818 does not even contain language designed to achieve that purpose.

9/ Report of the National Commission for the Review of Antitrust Laws and Procedures, supra, 177-189.

10/ See, e.g., Continental T.V., Inc. v. GTE Sylvania, Inc., supra, at 54-57.

potential benefits fully into account, however, weighing the anticompetitive effects of a restriction against any competitive benefits. If a particular agreement, on balance, fosters competition, it is legal as the law now stands. We see no reason to change the law to legalize agreements that cannot meet that standard.

Furthermore, under existing law, the courts consider whether any claimed competitive benefits could be achieved without completely eliminating intrabrand competition. H.R. 5818 would legalize the most extreme form of territorial restraint, the categorical prohibition on sales outside the assigned area, even when only a more limited restraint could be justified by the circumstances of the case. In many instances, we believe, less restrictive arrangements, such as area of primary responsibility clauses designed to encourage effective market penetration, would offer ample protection for the industry's legitimate needs. H.R. 5818 thus would afford bottlers and manufacturers a license completely to deprive consumers of the benefits of intrabrand competition even where less restrictive measures would suffice. Existing law, in contrast, allows the courts to consider whether exclusive territories are reasonably necessary to achieve legitimate business goals in light of the available marketing alternatives, an approach that we consider superior.

Moreover, to the extent this bill may be interpreted as applying to licensing agreements between competing manufacturers, distributors or sellers of soft drinks, it would substitute the inadequate standard discussed above for the current presumption against horizontal market division agreements. 11/ Existing law takes account of the special dangers they present, but does not bar consideration of special economic justifications for certain territorial agreements among competitors. 12/

The Department of Justice recognizes that many proponents of legislation to legalize territorial restrictions in the soft drink industry are motivated by a desire to encourage the use of returnable bottles, in order to conserve energy and protect the

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11/ In United States v. Topco Associates, Inc., 405 U.S. 596 (1972), competing distributors who jointly owned a trademark agreed among themselves to allocate exclusive territories for sales of the trademarked goods, and the Supreme Court held this horizontal division of markets illegal *per se* under the Sherman Act.

12/ *See* the final lower court order in *Topco*, accepted by the Supreme Court, which permitted such arrangements as "areas of primary responsibility." United States v. Topco ¶75,483 (amendment and opinion) (N.D. Ill. 1973), *aff'd*, 414 U.S. 801 (1973).

environment. These are declared purposes of H.R. 5818. The bill, however, contains no provision which requires, or even encourages, bottlers to use returnable bottles. This proposed legislation offers bottlers and manufacturers immunity from the antitrust laws for their vertical territorial agreements whether or not they make any effort to offer returnable bottles. Special legislation may be necessary where the market process is not fully able to take into account the total costs imposed on society by the sale of particular commodities, as in the case of environmental or safety hazards. Such legislation, however, should deal directly with the problem. Affording manufacturers and bottlers an unrestricted license to eliminate intrabrand competition in the hope that some of them may voluntarily choose to offer returnable bottles is not an efficient solution to energy or environmental problems.

Finally, proposed section 803 suggests 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. Under this standard, a vertical territorial restriction apparently would be immune from challenge unless a plaintiff could prove not only the absence of any interbrand competition but also that elimination of the restraint would not adversely affect the environment, significantly increase energy consumption, raise the price of soft drinks in any section of the nation, or promote concentration of economic power in the soft drink industry. The burden of proof however, belongs on the defendant. It is well settled in antitrust, as in other fields of law, that one who claims the benefit of an exception to a statutory prohibition has the burden of proof to establish the facts on which the exception is based. 13/ If there are justifications for a particular competitive restraint, the defendant should be required to assert and prove them. Requiring the plaintiff to undertake the much more difficult task of proving the negative proposition that no possible competitive, energy-related, environmental, or cost justification exists could effectively insulate even the most harmful restraints from the antitrust laws.

In sum, H.R. 5818 would legalize vertical territorial restraints which may have serious anticompetitive effects. 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. 5818 fails to give adequate recognition to the acknowledged potential of such restraints to produce higher prices without compensating benefits, and it would create what

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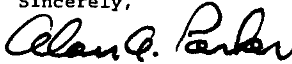
13/ *See, e.g.*, United States v. First City National Bank, 386 U.S. 361, 366 (1967).

may amount to an almost absolute rule of legality that would deprive consumers of their protection under current law. Congress has refused in previous years to impose higher prices on consumers for the benefit of the soft drink industry, and it should continue to do so.

We can see no reason to modify for a particular industry the already extremely flexible law on exclusive territories. Such a move can only encourage other industries to demand equal treatment. H.R. 5818 does not represent a constructive attempt to clarify the law on exclusive territories. It represents an effort by special interests to remove themselves from the application of antitrust rules designed to maximize competition and preserve efficiency. The Department of Justice recommends against enactment of this legislation.

The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,



Alan A. Parker
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