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Antitrust Law--Franchise Agreements--Exclusive Dealing Contracts Held Unfair Method of Competition Under Section 5 of the Federal Trade Commission Act (FTC v. Brown Shoe Co., 384 U.S. 316 (1966))

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RECENT DECISIONS

ANTITRUST LAW — FRANCHISE AGREEMENTS — EXCLUSIVE DEALING CONTRACTS HELD UNFAIR METHOD OF COMPETITION UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT. — The Federal Trade Commission, proceeding under Section 5 of the Federal Trade Commission Act, enjoined a large shoe manufacturer from entering into certain restrictive franchise contracts with independent retail shoestore operators. The agreements provided that, in return for certain valuable services, the dealers would not purchase conflicting lines of shoes from the manufacturer's competitors. The Supreme Court, reversing the circuit court, unanimously *held* that the Commission, in enjoining use of these contracts, acted within its powers even though there was no proof that the agreements amounted to an "outright violation" of the antitrust laws. *FTC v. Brown Shoe Co.,* 384 U.S. 316 (1966).

The Sherman Act, the first legislative attempt to maintain effective competition, was phrased in broad language which prohibited every contract in restraint of trade.[1] It was believed that detailed language might hinder legitimate enterprises and that explicit definitions might provide loopholes. It was left for the courts to decide what types of conduct Congress intended to prohibit. However, the courts' restrictive interpretation of the Sherman Act[2] led to the passage, in 1914, of the Clayton Anti-Trust Act[3] and the Federal Trade Commission Act.[4] The Clayton Act prohibits conduct, the effect of which may be to

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[1] 26 Stat. 209 (1890), 15 U.S.C. § 1 (1964). "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ."

[2] Howrey, *Utilization By The FTC Of Section 5 Of The Federal Trade Commission Act As An Antitrust Law,* 5 ANTITRUST BULL. 161-62 (1960).

[3] 38 Stat. 731 (1914), 15 U.S.C. § 14 (1964). This statute makes it "unlawful for any person engaged in commerce . . . to . . . make a . . . contract for sale of goods . . . for . . . resale within the United States . . . on the condition, agreement or understanding that the . . . purchaser thereof shall not use or deal in the goods of a competitor . . . of the . . . seller where the effect of such . . . condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

[4] 38 Stat. 717 (1914), as amended, 15 U.S.C. § 41 (1964). Section 5(a)(1) (15 U.S.C. § 45(a)(1)) provides that "unfair methods of competition in commerce . . . are declared unlawful."

"substantially lessen competition"; the Federal Trade Commission Act prohibits "unfair methods of competition." Both acts were specifically designed to attack trade practices which might restrain competition before those practices reached the stage of a "Sherman Act" violation.[5]

Although aware of the vagueness of the phrase "unfair methods of competition" as used in Section 5 of the Federal Trade Commission Act, Congress indicated its intention to use that language in order to provide the act with a flexible means of control over any new forms of monopolistic practices which might develop. Thus, it was left to the Federal Trade Commission and the courts to ascertain the scope of the phrase.[6]

The Supreme Court's interpretation of this phrase was consistently restrictive. In *FTC v. Gratz*,[7] the Court, in addition to limiting the power of the Federal Trade Commission, stated that the statute was

> clearly inapplicable to practices never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly.[8]

In this case and two later ones,[9] the Commission used section 5 to attack tying arrangements and exclusive dealership contracts.[10] In all three cases, the conduct was the type sought to be eliminated by the Clayton Act even though it did not come strictly within its terms. Nevertheless, the Court set aside the Commission's orders "because of the absence of a showing of a potentially substantial lessening of competition or tendency to monopoly threatened by the challenged trade practice—the criteria of illegality

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[5] FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392 (1953).

[6] S. REP. No. 597, 63d Cong., 2d Sess. 13 (1914).

[7] 253 U.S. 421 (1920). Acting under § 5, the Commission ordered a manufacturer to cease and desist from tying the sale of cotton ties to the sale of cotton bagging.

[8] *Id.* at 427.

[9] FTC v. Curtis Publishing Co., 260 U.S. 568 (1923) (a publisher's use of exclusive dealing contracts barring its wholesale distributors from handling competitive publications was found by the Court to be an agency relationship rather than one of sale); FTC v. Sinclair Ref. Co., 261 U.S. 463 (1923) (gasoline supplier provided storage tanks and pumps to its lessees upon the condition that only Sinclair gasoline be used with the equipment; the Court held that the written contracts involved did not expressly limit the lessee's right to use competitive products).

[10] When by virtue of a contract, the procurement of a desired product (the tying product) is conditioned upon the purchase of some other product (the tied product) in which the seller has a financial interest, the resulting relationship is styled a "contractual tying arrangement." Comment, *Antitrust Standards Of Illegality For Tying Arrangements*, 22 WASH. & LEE L. REV. 208 (1965).

under the Clayton Act."[11] Thus, in effect, the Supreme Court has held that section 5 was merely another method of attacking conduct which was prohibited by Section 3 of the Clayton Act. The Commission's scope of power under section 5 was thereby limited to conduct which met the anti-competitive standard of the Clayton Act.

During the 1940's, however, the Court's dicta began to exhibit a more liberal approach to the scope of section 5, and indicated that the Commission's power might extend to declaring unfair any conduct which was contrary to the *public policy* declared in the Sherman and Clayton Acts.[12] This reference to public policy indicated that the Federal Trade Commission Act could encompass conduct which, although not specifically within the terms of the other two acts, had the anti-competitive effect intended to be proscribed by the antitrust legislation. The resulting indecisiveness as to the exact extent of its authority under section 5 caused the Commission to act cautiously and to prohibit conduct only upon an "evidentiary and anti-competitive showing equivalent to that required under the Clayton Act,"[13] *i.e.*, a substantial lessening of competition. This was done even though the Commission consistently maintained that it had the power to enjoin tying arrangements under section 5 upon a lesser evidentiary showing than that required by section 3.

In *Times-Picayune Publishing Co. v. United States*,[14] the Supreme Court attempted to define the standards of illegality required to support a finding of a tying arrangement in violation of Section 3 of the Clayton Act (and, therefore, also in violation of Section 5 of the Federal Trade Commission Act). The Court stated that

> when the seller enjoys a monopolistic position in the market for the 'tying' product, *or* if a substantial volume of commerce in the 'tied' product is restrained, a tying arrangement violates the narrower standards expressed in § 3 of the Clayton Act because from either factor the requisite potential lessening of competition is inferred.[15]

However, in attacking tying arrangements under section 3, there was the problem of proving that a substantial lessening of

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[11] Howrey, *supra* note 2, at 166.

[12] See Fashion Originators' Guild of America, Inc. v. FTC, 312 U.S. 457, 463-64 (1940).

[13] Howrey, *supra* note 2, at 173.

[14] 345 U.S. 594 (1953).

[15] *Id.* at 608-09. The Court further adhered to the requirement, set down earlier, that the actions must affect a not "insignificant or insubstantial" amount of interstate commerce. *Id.* at 610. See International Salt Co. v. United States, 332 U.S. 392, 396 (1947).

competition in the tied item had occurred. Since the Supreme Court required the same showing of substantial restraint in section 5 proceedings, a similar problem arose in attempting to prove that a tying arrangement was an "unfair method of competition."

To determine whether a substantial anti-competitive effect existed, two tests were developed. The first test, that of quantitative substantiality, was enunciated by the Supreme Court in *Standard Oil Co. v. United States.*[16] The Court found that section 3 prohibited oil company contracts which required independent dealers to purchase *all* of their business requirements of one or more products from the company. This quantitative approach was denounced by many authors as being too mechanical for such a complex area of the law.[17] Such criticism led to the development by the Court of the second test, that of qualitative substantiality.[18] The Court indicated that, under the qualitative test, the mere dollar amount of competition affected should not be determinative, but rather, illegality would depend upon whether the arrangement tended to "substantially foreclose competition in the relevant . . . market." [19]

While the Supreme Court was operating under the quantitative standard, the Commission, in instituting proceedings under Section 5 of the Federal Trade Commission Act, was utilizing the qualitative test.[20] The qualitative test was particularly suitable for two reasons: (1) the Commission was made up of expert personnel who could call upon their experience to study the conduct attacked and judge its potential effects on the market; and (2) the wording of section 5 indicated that the Commission should act before the anti-competitive scheme was fully developed and, thus, before the full quantitative effects on competition could be known. However, since the Supreme Court was using the quantitative test of *Standard Oil* in its treatment of tying arrangements, the Commission made many strained attempts to reconcile its decisions under the qualitative test with the Supreme Court decisions.[21] Finally, in 1960, the Commission abandoned the

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[16] 337 U.S. 293 (1949) (contracts comprising $58,000,000 or 6.7% of total oil products sold in a seven state area). "[U]nder this test, if the proponent shows a sufficient percentage of foreclosure in the tied product, economic harm has been established. Under a strict application of this test, the quantity or percentage of the foreclosure is decisive and the Court makes no further inquiry." 22 WASH. & LEE L. REV., *supra* note 10, at 216.

[17] See Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements under the Clayton Act,* 1961 SUP. CT. REV. 267, 275.

[18] Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1962).

[19] *Id.* at 334.

[20] See, *e.g.,* Maico Co., 50 F.T.C. 485 (1953).

[21] Bok, *supra* note 17, at 277-80.

qualitative test and adopted the *Standard Oil* rule.[22] However, it was at about this time that the Supreme Court acceded to the critics of *Standard Oil* and adopted the qualitative standard.[23] As a result, the Court and the Commission were still using opposing tests to determine the effect of tying arrangements on competition.

In the principal case, under the terms of "Brown's Franchise Stores' Program," the independent retailers entering into the franchise agreements were provided with certain valuable services such as special group insurance rates, services of Brown's field representatives and architectural plans. These services were not made available to non-franchise customers even though they could purchase Brown's lines of shoes. In return, the retailer agreed to *concentrate* his business within Brown Shoe Company lines and not to handle any conflicting lines of shoes manufactured by Brown's competitors. It appeared from the record that an average of about 75 per cent of the stock of the 766 retail stores in the program was purchased from Brown. In some individual instances the amount ran as high as 95 per cent. The result was the elimination of these retailers as markets for manufacturers producing competing lines of shoes. This loss was evidenced by statistics indicating a decrease in the sales of other manufacturers directly attributable to the franchise agreements.

The Commission examined a prior case involving the same defendant to find the standard of illegality necessary to declare the franchise agreements violative of the antitrust laws.[24] In *Brown Shoe Co. v. United States*[25] (the *Merger Case*), the Court had condemned the merger of Brown Shoe Company and a large chain of retail shoe dealers. This form of "vertical integration"[26] (a vertical merger) had been attacked under Section 7 of the Clayton Act.[27] Although the Court had found that the merger

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[22] Mytinger v. Casselberry, Inc., 1960-61 Trade Reg. Rep. ¶29,091 (1960) (final order), *aff'd*, 301 F.2d 534 (D.C. Cir. 1962), *overruling* Maico Co., *supra* note 20.

[23] Tampa Elec. Co. v. Nashville Coal Co., *supra* note 18.

[24] Brown Shoe Co., Trade Reg. Rep. (1963 Transfer Binder) ¶16,316.

[25] 370 U.S. 294 (1962).

[26] Vertical integration has been defined as "that type of organization that comes into existence when two or more successive stages of production and/or distribution are combined under the same control." COLE, VERTICAL INTEGRATION IN MARKETING 99 (1952).

[27] 38 Stat. 731 (1914), as amended, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964). "No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

would result in only about one per cent of the total retailers being foreclosed from the other manufacturers, it nevertheless prohibited the merger after investigating the entire industry and finding a general trend toward vertical integration by merger.[28] Thus, the Court had used the qualitative test to determine how substantially a vertical merger could affect competition.

Since section 7 is concerned with mergers and acquisitions rather than contractual arrangements, the Commission's use, in the instant case, of the *Merger Case* and its standard of illegality to determine section 3 illegality in a franchise case seemed strange. However, the Commission indicated that it found no substantial distinction between the effect on competition of a vertical merger and the franchise method of acquiring vertical integration. The fact that a merger was permanent while a contract could be abandoned at will by the franchisee was considered unimportant. The significant fact, according to the Commission, was that the manufacturer controlled the dealer, and that this control, even though it could be ended, tended to adversely affect competition. In actuality, since none of the franchised dealers had indicated dissatisfaction with the agreements, the effect of the contracts was integration quite similar to a merger. The increase in membership indicated that the effect of Brown's plan was a lessening of competition by a decrease in the number of retailers able to carry other manufacturers' shoes. Thus, in effect, by making use of the *Merger Case,* the Commission indicated its intention to adhere, once again, to the qualitative approach in attacking contractual tying arrangements under section 5.

In contesting the Commission's initial cease and desist order, Brown had advocated a quantitative approach to its franchise program, arguing that the agreements could only be declared illegal upon a finding that the program had a substantial anticompetitive impact upon the nationwide shoe market. Since the shoes sold by Brown constituted less than one per cent of national shoe sales, and since only a small number of the total stores classified as retail shoe stores were involved,[29] Brown contended that the franchise plan involved control over an unsubstantial part of the nationwide market. The Commission, in rejecting this approach, returned to its findings in the *Merger Case* to examine the effect of Brown's conduct under the franchise program. Evidence indicated that the shoe industry was a topheavy one in which the five largest manufacturers produced twentyfour per cent of the total output of shoes. Of approximately one thousand shoe manufacturers in the country, Brown ranked

[28] Brown Shoe Co. v. United States, 370 U.S. 294, 345 (1962).
[29] Brown Shoe Co., *supra* note 24, at 21,144.

second in dollar volume and third in shoe production.[30] During the thirty-year existence of the Brown franchise program there had been a definite increase in the number of members. Testimony indicated that it had become progressively more difficult for smaller manufacturers to find retail outlets since most of the retailers were involved in franchise plans maintained by Brown and the other large manufacturers. These factors, coupled with a "trend in the shoe industry generally and on the part of the respondent [Brown] in particular to vertical integration . . . ,"[31] indicated a clearly deteriorating competitive situation requiring Commission action.

The court of appeals rejected the Commission's holding, refusing to look upon the franchise program as a tying agreement such as that found to be anti-competitive by the Supreme Court in *Northern Pac. Ry. v. United States.*[32] In that case, the railroad had a monopoly of the land along its routes and tied the sale or lease of this land to the use of its hauling services. This was accomplished by means of clauses in the contracts of sale and leases which compelled the buyer or lessee to ship over Northern Pacific lines all commodities produced or manufactured on the land. The Supreme Court, while holding that there was an anti-competitive tying arrangement, nevertheless, limited its decision by stating that

> where the seller has no control or dominance over the tying product . . . so that it does not represent an effectual weapon to pressure buyers into taking the tied item . . . any restraint of trade attributable to such tying arrangements would obviously be insignificant at most.[33]

Brown, however, had no such monopoly in the services offered (the tying item) since similar services were offered by other manufacturers under their own franchise programs. Thus, these services offered no "effectual weapon" to force Brown shoes (the tied item) on the retailers. In effect, the court of appeals was applying the quantitative test of illegality—the "quantity" of the market required for illegality being a monopoly in the tying item.

In reversing the court of appeals, the Supreme Court investigated the record and noted that no rejection was made of the Commission's findings as to the effect of the franchise program on competition. It further indicated that, based upon earlier Supreme Court cases, it was well established that

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[30] *Id.* at 21,145 n.36.
[31] *Id.* at 21,146.
[32] 356 U.S. 1 (1958).
[33] Brown Shoe Co. v. FTC, 339 F.2d 45, 54 (8th Cir. 1964).

the Commission has broad powers to declare trade practices unfair. This broad power of the Commission is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws.[34]

The Court went on to state that the record clearly indicated a program which, if enforced (as it had been), would tend to impede retailers' dealings with Brown's competitors. Finally, the Court stated that since the Commission had acted under Section 5 of the Federal Trade Commission Act, rather than under Section 3 of the Clayton Act, proof that the conduct might substantially lessen competition was not needed to prove an "unfair method of competition." [35]

This decision appears to have a twofold effect on the treatment of tying arrangements by the Federal Trade Commission. First, it now seems clear that the Commission's claimed ability to act under section 5, upon a smaller quantum of proof of a lessening of competition than is required under section 3 proceedings, has the support of the Court. The Court made clear that it rejected Brown's contention that the Commission could not act without direct proof that competition would be lessened. It has become clear that the Federal Trade Commission Act is a separate and distinct antitrust law with its own requirements. The second result of the decision involves the standard of illegality to be used in attacking tying arrangements. The Court's position seems to indicate agreement with the qualitative test utilized by the Commission. As a result of this implicit approval of the qualitative standard for determining the anti-competitive effect of tying arrangements, the Supreme Court and the Commission, for the first time, are making use of a common test of illegality.

The Court's acceptance of the qualitative test creates pitfalls for the antitrust counselor. He would much prefer a quantitative test so that he could more easily determine the limits of control which a manufacturer may maintain over a retailer and still remain beyond the scope of the antitrust laws. Faced, however, with a qualitative standard, his ability to define a violation is greatly diminished. The percentage of competition eliminated is not necessarily determinative. Even an infinitesimal percentage of a market cornered by a manufacturer could be deemed a violation after the fact-finders have investigated the economic and historical background of the particular industry. Although this power to define a section 5 violation is broad, judicial review should provide a sufficient safeguard against the danger of abuse by an overzealous Commission.[36]

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[34] FTC v. Brown Shoe Co., 384 U.S. 316, 320-21 (1966).
[35] *Id.* at 322.
[36] See Atlantic Ref. Co. v. FTC, 381 U.S. 357 (1965).

It seems clear that the new flexibility given the Federal Trade Commission by this decision is desirable. No longer need the Commission wait until the standards of illegality demanded by Section 3 of the Clayton Act are met in order to attack a particular trade practice. Instead, the Commission can now act in the manner originally intended and bring to a halt any unfair method of competition at the first hint of a potential lessening of competition.[37] However, this power is apparently limited by the condition that the practice attacked must *resemble* a Clayton Act violation, even though it is not specifically within the purview of that act.

CONSTITUTIONAL LAW — CONGRESSIONAL INVESTIGATIONS — CONTEMPT CONVICTION HELD VOID WHERE SUBCOMMITTEE INQUIRY IS NEITHER SPECIFIED NOR AUTHORIZED BY PARENT COMMITTEE. — Petitioner, while testifying before a Subcommittee of the House Un-American Activities Committee, refused to answer questions concerning his alleged Communist affiliations. He chose not to invoke the privilege against self-incrimination, but instead challenged the jurisdiction of the Committee and its Subcommittee, the authorization of each, and the constitutionality of the inquiry in general. The petitioner was convicted of contempt of Congress. This conviction was unanimously reversed by the United States Supreme Court which *held* that petitioner was not in contempt since the subject matter of the inquiry was never specified by the Committee, as required by its own rules, nor was there a lawful delegation of authority to the Subcommittee to conduct the investigation. *Gojack v. United States,* 384 U.S. 702 (1966).

The power of Congress to punish witnesses for contempt is derived by implication from its constitutional power to punish the contumacious behavior of its own members.[1] The purpose of this power is the self-protection of the legislative forum and the furtherance of its lawmaking functions.[2] Also, inherent in the congressional power to formulate laws is the power to investigate.[3] If legislation is to be sound it must be the product of a well-informed legislature, and undoubtedly one of the best methods of obtaining information is to conduct fact-finding hearings and

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[37] S. REP. No. 597, 63d Cong., 2d Sess. 13 (1914).

[1] Anderson v. Dunn, 19 U.S. (6 Wheat.) 204, 225 (1821). "Each House may determine the Rules of its Proceedings, punish its Members for Disorderly Behaviour, and, with the Concurrence of two thirds, expel a Member." U.S. CONST. art. I, § 5.

[2] Landis, *Constitutional Limitations on the Congressional Power of Investigation,* 40 HARV. L. REV. 153, 158-60 (1926).

[3] McGrain v. Daugherty, 273 U.S. 135, 160. (1927).