NOTES

ANTITRUST LAW—FRANCHISING—RESTRICTIVE ASPECTS OF MOTEL FRANCHISING SYSTEM INDIVIDUALLY AND CUMULATIVELY HELD TO VIOLATE THE SHERMAN ACT—*American Motor Inns, Inc. v. Holiday Inns, Inc.*, 365 F. Supp. 1073 (D.N.J. 1973).

The use of franchise systems of distribution has recently "developed into a way of life in the business community."[1] One of the most rapidly expanding forms of this phenomenon is that of industries dealing in particular services rather than in manufactured products.[2] The basis for any franchise relationship is the written franchise agreement and it is through a precise structuring of this contract that franchisor and franchisee ultimately decide upon "[w]ho gives up how much to whom."[3] As a result of this interaction, the written agreement will

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1 Address by Everette MacIntyre, Federal Trade Commissioner, Conference of Int'l Franchise Ass'n, May 8, 1969, in 5 TRADE REG. REP. ¶ 50,105, at 55,117 (1972). In 1965, based on statistics collected two years previously, it was estimated that there were 338,000 franchised outlets in operation, accounting for an annual volume of approximately $60 billion. *Hearings on Distribution Problems Affecting Small Business Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 1st Sess., pt. 1, at 7 (1965) [hereinafter cited as *1965 Hearings*]. By 1967, this figure had risen to more than 450,000 franchised outlets, doing an annual business of $70-90 billion. Note, *Territorial and Customer Restrictions: A Trend Toward a Broader Rule of Reason?*, 40 GEO. WASH. L. REV. 123, 144 n.167 (1971). If the current rate of growth continues, it has been forecasted that by the year 1980 there will be an additional 500,000 franchises, resulting in an annual revenue of $165 billion. Kamenshine, *Competition Versus Fairness in Franchising*, 40 GEO. WASH. L. REV. 197, 199 n.13 (1971) (citing SUBCOMM. ON URBAN AND RURAL ECONOMIC DEVELOPMENT OF THE SENATE SELECT COMM. ON SMALL BUSINESS, 91st Cong., 2d Sess., IMPACT OF FRANCHISING ON SMALL BUSINESS 7 (Comm. Print 1970)).

2 Pollock, *Antitrust Problems In Franchising*, 15 N.Y.L.F. 106, 116 (1969). This particular type of franchise relationship has consistently been distinguished from one which deals with a manufactured product, and has been given as many titles as there are commentators. *See, e.g.*, Remarks by Donald I. Baker, Director of Policy Planning, Antitrust Division, Prepared for Delivery at the Briefing Conference on New Developments in Advertising and Marketing Law, Feb. 29, 1972, in 5 TRADE REG. REP. ¶ 50,130, at 55,213 (1972) (referring to this type of situation as "image franchising"); Averill, *Sealy, Schwinn and Sherman One: An Analysis and Prognosis*, 15 N.Y.L.F. 39, 73 (1969) ("service franchising"); Pollock, *supra* at 106 ("licensing" or "package" franchising). For a functional analysis of various types of franchise systems in different industries, see Chadwell & Rhodes, *Antitrust Aspects of Dealer Licensing and Franchising*, 62 NW. U.L. REV. 1, 3-4 (1967), where the authors attempt to categorize these relationships according to their specific purposes.

3 DEP'T OF COMMERCE, THE LOCAL ECONOMIC DEVELOPMENT CORPORATION: LEGAL AND FINANCIAL GUIDELINES 66 (1970). A number of franchise contracts, as utilized by a random sampling of businesses, were collected pursuant to a study by the United States Senate, and serve as excellent examples of standard form agreements. *1965 Hearings, supra* note 1, at 403-55.

usually include specific clauses restricting the actions of the franchisee.[4] One particular type of restriction in a service franchise contract, and its interrelation with other facets of the underlying franchise system, were recently found to constitute a violation of section 1 of the Sherman Antitrust Act[5] in *American Motor Inns, Inc. v. Holiday Inns, Inc.*[6]

Holiday Inns, Inc. is a publicly-held corporation which is currently the largest hotel-motel franchisor in the United States.[7] The entire Holiday Inns System is an organization of hotels and motels, both franchised and company-owned,[8] encompassing such group-oriented projects as an employee training school and a national advertising program.[9] The total yearly revenue of the combined system is approximately one billion dollars.[10] American Motor Inns, Inc. (AMI) is in the business of owning or operating Holiday Inns and is presently its largest franchisee, operating forty-eight inns.[11]

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4 Some of the restrictions which are usually inserted into a service franchise agreement

> are clauses which prescribe a particular location for the business, prohibit the franchisee from operating any other similar service or facility elsewhere, specify materials and the sources for these materials, prohibit the franchisee from separately identifying and advertising his own franchised outlet and prohibit sales of other than the franchisor's products.

Averill, *supra* note 2, at 73. There are varying reasons for the inclusion of such restraints, but the most common proposed justification is the necessity for maintaining quality control in order to protect the franchisor's good will and trademark. *See, e.g.*, Chadwell & Rhodes, *supra* note 2, at 2; Comment, *Tying and Exclusive Dealing Agreements: Protection for Franchise Trademark Licensors*, 45 TULANE L. REV. 1016, 1016-17 (1971).

5 15 U.S.C. § 1 (1970). The Act reads in pertinent part:

> Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . .

6 365 F. Supp. 1073 (D.N.J. 1973).

7 *Id.* at 1077. The increase in the number of Holiday Inns during the past decade is indicative of the rapid expansion in franchised industries. As recently as 1963, there were only 280 Holiday Inn franchises in operation. *1965 Hearings*, *supra* note 1, at 373. The number of Holiday Inn franchises in 1972 was reported as 1,470. 365 F. Supp. at 1077. This indicates a 425 percent rate of growth during a nine year period. For a comparative listing of other hotel-motel chains, see *id.* at 1085.

8 365 F. Supp. at 1077. Of the 1,470 Holiday Inns in existence as of December 31, 1972, 297 were directly owned or operated by Holiday Inns, Inc. or its subsidiaries, while 1,173 were independently owned or operated in accordance with franchising agreements. Within the United States, these totals were 281 and 1,099 respectively. *Id.*

9 Defendant's Post-Trial Memorandum at 4, 24, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973) [hereinafter cited as Defendant's Post-Trial Memorandum].

10 365 F. Supp. at 1077.

11 *Id.* The growth of American Motor Inns, Inc. is comparable to that of Holiday Inns. In 1957, American Motor Inns, Inc. began its investment with a single Holiday Inn franchise. Defendant's Trial Memorandum at 4, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973) [hereinafter cited as Defendant's Trial Memo-

In March, 1971, AMI, acting through a real estate agent, submitted a bid to the City of Elizabeth, New Jersey, to purchase a parcel of land situated near the proposed site of the terminals for the renovated Newark International Airport. This bid was accepted in April, 1971, and the property was conveyed to AMI on December 30, 1971, by way of a deed restricting the use of the land to the construction " 'of a multi-story hotel-motel-office complex.' "[12] Within a short time AMI filed an application with Holiday Inns for a license enabling AMI to operate a Holiday Inn on that property.[13]

In accordance with its usual procedure upon receipt of license applications, Holiday Inns sent "radius letters" to the three closest franchisees, "soliciting their comments on the application."[14] Two of these inquiries were answered with strong objections to the issuance of a license for the Elizabeth property.[15] With this information in hand, the Holiday Inns Franchise Committee unanimously denied the application on October 8, 1971.[16] AMI then considered the possibility of constructing a Sheraton Inn at the airport site and inquired about the possibility of a waiver of the "non-Holiday Inn clause" contained in all Holiday Inn franchise agreements. This clause ordinarily prohibits all franchisees from any affiliation with other hotel-motel operations.[17]

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randum]. By 1972 the corporation realized $44 million per year from the operation of its 48 inns. 365 F. Supp. at 1077. For a general analysis of the expansion of franchise systems in the entire hotel-motel industry, see Statement of the American Hotel & Motel Ass'n, in *Hearings on S. 2507 and S. 2321 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 90th Cong., 1st Sess., at 447-48 (1967).

12 365 F. Supp. at 1085.

> The deed further provided that "The grantee shall have a period of one (1) year from the date hereof to commence construction as contemplated and shall complete at least one million dollars ($1,000,000.00) worth of improvements within eighteen (18) months thereafter."

Id.

13 *Id.*

14 *Id.* Holiday Inns stated that this procedure was standard whenever new applications were received. The alleged motivation behind this process is to provide additional data "by which Holiday Inns can intelligently judge the feasibility of the operation of a new motel or hotel on a particular site." Defendant's Trial Memorandum at 9. In this particular instance, the three closest inns were located in Carteret, Downtown Newark, and at Newark Airport. 365 F. Supp. at 1085.

15 The Carteret franchisee objected by letter, contending: "An inn directly across from the Airport . . . would definitely take business away form [*sic*] my inn at Carteret." 365 F. Supp. at 1085. Arthur Fleck, the Newark Airport franchisee, objected "in a series of letters, conversations and meetings," explaining that "it was so close to [his inn]." *Id.*

16 *Id.* at 1086. The amount of consideration given to the objections of the Newark Airport and Carteret licensees by the Franchise Committee, and the related question of their actual effect on the treatment of the AMI application, were important issues at the trial. See discussion pp. 326-29 *infra*.

17 365 F. Supp. at 1087. This portion of the franchise agreement is referred to by

AMI's formal request was met with a rejection by the Holiday Inns Executive Committee[18] and consequently, AMI filed suit against Holiday Inns, alleging violations of sections 1 and 2 of the Sherman Antitrust Act.[19]

On April 9, 1973, the International Association of Holiday Inns (IAHI)[20] succeeded in intervening as a party defendant to the action.[21] At the same time, AMI's motion for partial summary judgment was denied without prejudice, the court "rejecting plaintiff's contention, at

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Holiday Inns as the "no-conflict-of-interest clause." Defendant's Trial Memorandum at 12. This clause states

> "that licensee will not, directly or indirectly, own any interest in, operate, or be in any manner connected with or associated with, any inn, hotel or motel, during the period of this license, except Holiday Inns."

365 F. Supp. at 1081 (quoting from Holiday Inns Standard License Agreement). Holiday Inns has indicated that if a violation occurs and there has been no compliance after a six-month period, the franchise will be terminated. *Id.* at 1082.

18 365 F. Supp. at 1087.

19 15 U.S.C. §§ 1-2 (1970). AMI then decided, at a pre-trial conference in May, 1973, to completely withdraw its section 2 argument. 365 F. Supp. at 1076. The trial was therefore conducted solely in response to AMI's section 1 claims.

Specifically, AMI contended the following in regard to section 1 of the Sherman Act:

> [AMI] alleges that [the non-Holiday Inn] clause is illegal and that it prevents, eliminates and hinders competition in areas throughout the United States, including the Greater Newark area . . . .
>
> [AMI] also alleges that defendant [Holiday Inns, Inc.] has conspired with its franchisees, including one presently located at the Newark airport, to deny AMI's application for a franchise near said airport and that in furtherance of said conspiracy it used the non-Holiday Inns clause to preclude AMI from competing in that market . . . .

Plaintiff's Trial Memorandum at 2, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973) [hereinafter cited as Plaintiff's Trial Memorandum].

Jurisdiction for the action was based upon 15 U.S.C. §§ 15, 26 (1970), which authorize treble damages in antitrust actions instituted by private litigants. 365 F. Supp. at 1076.

20 IAHI "is a non-profit unincorporated association of licensed owners or operators of Holiday Inns, including company owned or operated Inns." 365 F. Supp. at 1077.

> Its purpose, according to the standard form of Holiday Inns license, is "to consider and discuss common problems relating to the operation of Holiday Inns and to make recommendations with respect to Rules of Operation, advertising expenditures and other appropriate matters."

Plaintiff's Trial Memorandum at 6.

21 IAHI intervened pursuant to FED. R. CIV. P. 24(b)(2). At the conclusion of the presentation of AMI's case at trial, the court, with AMI's consent, granted IAHI's motion to dismiss as against it. 365 F. Supp. at 1076. The court then granted IAHI's request to remain as amicus curiae and allowed it to present evidence through Holiday Inns. *Id.* at 1076 n.3. IAHI's original purpose for intervening was expressed as follows:

> IAHI requested permission to intervene in this case to defend against plaintiff's charge in the complaint of a conspiracy to restrain interstate trade and commerce in the hotel-motel lodging industry . . . as well as to sustain the non-Holiday Inn clause as a contract not in unreasonable restraint of trade.

Post-Trial Memorandum of International Ass'n of Holiday Inns, as Amicus Curiae at 3, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973) [hereinafter cited as Post-Trial Memorandum of IAHI].

that point in the case, that the non-Holiday Inn clause was illegal."[22] The first portion of a bifurcated trial, held without a jury, began on May 9, 1973, to assess the validity of AMI's contention that various aspects of Holiday Inns' franchising system, both individually and cumulatively, were violative of section 1 of the Sherman Act.[23] The three specific practices challenged by AMI were: (1) the solicitation of comments through "radius letters," (2) an alleged reluctance to grant new franchises in towns where Holiday Inns, Inc. owned or operated an inn, and (3) the non-Holiday Inn clause.[24]

When confronted with a section 1 complaint, a court may proceed in either of two distinct manners. Although the Sherman Act condemns "[e]very contract, combination . . . or conspiracy, in restraint of trade,"[25] the Supreme Court, in *Standard Oil Co. v. United States*,[26] interpreted the statute as prohibiting only those acts which were deemed to be unreasonable.[27] This first method of analysis is referred to as the "rule of

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22 365 F. Supp. at 1076.

23 *Id.* at 1076-77. It had been agreed at a pre-trial conference on May 2, 1973, that "the damage issue was to be tried, if necessary, after decision on the question of liability and the propriety of injunctive and declaratory relief." *Id.* at 1076.

24 *Id.* at 1076-77. Those towns in which Holiday Inns owns or operates its own inn are referred to as "parent company towns."

25 15 U.S.C. § 1 (1970).

26 221 U.S. 1 (1911) (where the practices of Standard Oil Company of New Jersey were found to constitute a combination in the petroleum industry which was in violation of the Sherman Act).

27 *Id.* at 60, where the Court stated:

> Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason . . . was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.

The first rule of reason standard is believed to have been formulated in Mitchel v. Reynolds, 24 Eng. Rep. 347 (Ch. 1711). In *Mitchel*, the court was concerned with the validity of a bond in which a baker had promised to refrain from conducting business in a particular area. It was decided that "the Court is to judge [the] circumstances, and determine [the validity] accordingly." *Id.* at 352. This test was later put into a form resembling the currently accepted standard: "But the greater question is, whether this is a reasonable restraint of trade." Horner v. Graves, 131 Eng. Rep. 284, 287 (C.P. 1831) (where an agreement by a dentist not to practice in a 200 mile district was held to be unreasonable and void).

The invalidity of certain restraints at common law was recognized during the Senate debates over the desirability of passing the proposed Act. Senator Sherman then stated:

> It is the unlawful combination, tested by the rules of common law and human experience, that is aimed at by this bill, and not the lawful and useful combination.
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> . . . .
>
> The sole object of such a combination is to make competition impossible. . . .
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> It is this kind of a combination we have to deal with now.

21 CONG. REC. 2457 (1889). It was later acknowledged that the practices to be prohibited

reason" approach.[28] The second alternative concerns particular types of conduct which have been branded illegal "per se," as described by the Court in *United States v. Trenton Potteries Co.*[29] The procedural distinction between these two investigatory techniques is directly re-

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by the bill were those which were invalid at common law in England, and the necessity for the Act was the lack of a "common law of the United States." 21 CONG. REC. 3152 (1889) (remarks of Senator Hoar). The original intent behind the enactment of the statute was spoken of in retrospect a few years later: "It was not thought that it included every restraint of trade, whether healthy or injurious." 36 CONG. REC. 522 (1903) (remarks of Senator Hoar). *See also* 14 S. WILLISTON, LAW OF CONTRACTS § 1650 (3d ed. 1972). It was in recognition of these proceedings that Justice White proposed the standard of reasonableness in *Standard Oil.* 221 U.S. at 50.

[28] 221 U.S. at 66. An early set of guidelines for the rule of reason approach was presented by Justice Brandeis as follows:

> Every agreement concerning trade, every regulation of trade, restrains. . . . 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.

Board of Trade v. United States, 246 U.S. 231, 238 (1918). For an excellent study of the historical development of the rule of reason which specifically analyzes the transition in the Supreme Court, see Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pt. 1), 74 YALE L.J. 775 (1965).

[29] 273 U.S. 392 (1927). In a discussion of price-fixing agreements, the Court stated:

> Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions. Moreover, in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies.

Id. at 397-98.

In addition to price-fixing arrangements, the Supreme Court has classified certain other trade practices as illegal per se. *See, e.g.*, Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951) (division of markets between competitors); Fashion Originators' Guild of America, Inc. v. FTC, 312 U.S. 457 (1941) (group boycotts). *See also* Chronological Evolution of the Per Se Doctrine, Submitted by the Federal Trade Commission, in *Hearings on S. 2549 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 2d Sess., pt. 3, at 1117-22 (1966).

Owing to the seemingly mechanical nature of a true per se test, this doctrine has been the subject of much criticism. *See, e.g.*, Bork, *The Rule of Reason and the Per Se Concept: Pricing Fixing and Market Division* (pt. 2), 75 YALE L.J. 373, 384-85 (1966); Chadwell & Rhodes, *supra* note 2, at 14; Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1158 (1952); Van Cise, *The Future of Per Se in Antitrust Law*, 50 VA. L. REV. 1165, 1176-77 (1964).

lated to the burden of proof and the admissibility of evidence.[30] In deciding *Holiday Inns*, the district court apparently found that the contested franchising scheme could not initially be categorized as a per se violation and consequently elected to pursue a rule of reason analysis.[31] Each of the three challenged procedures was then individually evaluated.[32]

The first aspect of the Holiday Inns franchise system scrutinized by the court was the standard policy of sending radius letters to the owners or operators of the three inns nearest to the proposed site.[33] The court found that although Holiday Inns' Franchise Committee was ordinarily empowered to grant applications for new licenses, a different procedure was followed when an objection was received in response to a radius letter. In the latter situation, only the Executive Committee could grant the application.[34] AMI contended that Holiday Inns' practice of soliciting comments from its potential competitors constituted an illegal restraint of intra-brand competition similar to that which had been condemned by the Supreme Court in *United States v. Arnold, Schwinn & Co.*[35] In deciding *Schwinn*, the Court recognized that it is not necessary that restraints imposed upon distributors of manufactured products affect inter-brand competition in the market as a whole, in order for such a scheme to be in violation of the Sherman Act.[36]

The court distinguished *Schwinn*, however, and chose to compare the radius letter policy to the procedure found to be illegal in *United*

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30 Oppenheim, *supra* note 29, at 1150-52. Another author noted:

> [O]ne can see that if a per se label is attached to a business practice there is a substantial difference in the evidence that may be presented at trial.

Sadd, *Territorial and Customer Restrictions After Sealy and Schwinn*, 38 U. CIN. L. REV. 249, 252 (1969). For a further comparison of the rule of reason and per se concepts, see 1 R. CALLMANN, THE LAW OF UNFAIR COMPETITION: TRADEMARKS AND MONOPOLIES § 15.3(a) (3d ed. 1967).

31 365 F. Supp. at 1076 (where the court refers to the denial of partial summary judgment). AMI had requested the court to declare "that the non-Holiday Inns clause is illegal *per se* under Section 1 of the Sherman Act." Plaintiff's Trial Memorandum at 3 (emphasis in original).

32 365 F. Supp. at 1088, 1091, 1093.

33 *Id.* at 1088. *See* note 14 *supra*.

34 365 F. Supp. at 1079, 1088.

35 388 U.S. 365 (1967). In *Holiday Inns*, the plaintiff contended that the radius letter policy was illegal per se under *Schwinn*. 365 F. Supp. at 1088-89. In analyzing the effect of the radius letter policy, the court defined the area of intra-brand competition as "competition among Holiday Inns franchisees in the market of 'Holiday Inn motel beds.'" *Id.* at 1088 n.4.

For a detailed analysis of *Schwinn's* impact on franchising systems, see Pollock, *Alternative Distribution Methods After Schwinn*, 63 NW. U.L. REV. 595 (1968).

36 388 U.S. at 369-70, 379.

States v. Topco Associates, Inc.[37] It was acknowledged that Holiday Inns was separate and distinct from its individual franchisees, whereas the association in *Topco* was comprised of the individual operators.[38] The court found, however, that the overall effects of the two systems

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[37] 405 U.S. 596 (1972). The main distinction between the systems in *Schwinn* and *Topco* is the classification of the former as "vertical" and the latter as "horizontal." 365 F. Supp. at 1089.

In order to achieve a workable means of differentiation, it is necessary to focus on the market position of the parties involved in the agreement. According to this type of analysis, vertical restraints are defined as "agreements between persons at different levels of distribution, as between a manufacturer and a wholesaler or retailer, or between a wholesaler and a retailer." J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION § 1.03[4][a], at 1-51 (16 BUSINESS ORGANIZATIONS rev. 1971) [hereinafter cited as VON KALINOWSKI]. Horizontal restraints are contrastingly defined as "agreements between persons at the same level of distribution, most commonly between firms in direct competition with each other." *Id.* § 1.03[4][b], at 1-54. An attempt to discuss the actual differences between the two types of arrangements has long been a source of confusion in cases involving complex fact patterns. Bork, *supra* note 29, at 424-29; Comment, *Horizontal Territorial Restraints and the Per Se Rule*, 28 WASH. & LEE L. REV. 457, 461 (1971).

In *Topco*, the Court was faced with a situation where small independent grocery chains had formed a cooperative association to act as their agent in procuring and distributing items possessing a Topco label. The association bylaws contained provisions for exclusive territorial licenses, allowing for expansion only with the consent of the nearest member. The Court found that the granting of membership, which normally required a 75% affirmative vote of the members, necessitated an 85% affirmative vote if the application was objected to by the closest licensee or any member located within 100 miles of the applicant's operations. 405 U.S. at 598-602. The Court found the entire Topco system to be a horizontal restraint of trade in violation of section 1 of the Sherman Act. *Id.* at 608.

See generally Note, *Horizontal Restraints of Trade, Absent Any Other Condemned Business Practice Are Per Se Violations of the Sherman Act*, 22 CATH. U.L. REV. 684 (1973). For analyses of the lower court's decision in *Topco*, see Note, *United States v. Topco Associates*, 12 B.C. IND. & COM. L. REV. 1240 (1971); Note, *United States v. Topco Associates, Inc.: Illegal Combination and/or Procompetitive Arrangement?*, 47 IND. L.J. 157 (1971).

Agreements between competitors to divide markets horizontally have been described as

> agreements with no purpose other than the elimination of competition; and, where significant shares of the market are involved, their effect on the degree of competition in the market can be severe.

ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, FINAL REPORT, 26 (1955) [hereinafter cited as REPORT]. *Accord*, White Motor Co. v. United States, 372 U.S. 253, 263 (1963) ("[h]orizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition"). That type of agreement is therefore classified as illegal per se. *Id.*; 1 R. CALLMANN, *supra* note 30, § 15.3(a), at 340.

[38] 365 F. Supp. at 1089. In *Topco*, each of the operators owned an equal number of voting shares in the association and all of the important officials were selected from the membership, thus giving "the members complete and unfettered control over the operations of the association." 405 U.S. at 598-99. Holiday Inns, however, is an entirely separate entity from IAHI. Accordingly, while the new Topco memberships were granted by the association of licensees, in the instant situation, franchise applications were approved by the parent corporation. 365 F. Supp. at 1090.

were sufficiently analogous to conclude that the final result in both situations was a horizontal allocation of territories restricting intra-brand competition.[39]

Even though a particular business practice may serve to severely restrain competition, in order for it to be subject to the proscriptions of the Sherman Act, it must be found to be a "contract, combination . . . or conspiracy."[40] A practice which is completely unilateral in nature does not fall within the prohibitions of the Act.[41] This was precisely the

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39 365 F. Supp. at 1090. The court's comparison of the procedures used to grant applications in each system was determinative of the outcome of this question. In each of the situations, an objection from a licensee required the application to be subjected to further scrutiny. *Compare* 405 U.S. at 602 *with* 365 F. Supp. at 1079. The *Holiday Inns* court concluded that

> in 57 percent of the applications brought to the Executive Committee, the objection resulting from the mailing of radius letters acted as a "veto of sorts" in the same manner as the increased approval percentage in Topco was held by that Court to act as a "veto".

Id. at 1090. It is interesting to note, however, that the percentage spoken of was based upon a total of only 75 applications. *Id.* at 1079. This would seem to indicate that it is the procedure itself, not the number or percentage of applications affected by it, which is being condemned by the court.

40 15 U.S.C. § 1 (1970). *See generally* Day, *The Theories of Agreement and Combination*, 42 ANTITRUST L.J. 287 (1973); Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962).

41 United States v. Colgate & Co., 250 U.S. 300, 307 (1919), where the Court stated:

> In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.

See Kamenshine, *supra* note 1, at 200-02. Kamenshine begins his examination of the requirement of mutuality by interpreting *Colgate* as necessitating an agreement. He continues by noting that

> a progression of Supreme Court decisions . . . has severely diluted the agreement requirement and has brought various forms of essentially unilateral anticompetitive practices within the ambit of Sherman 1.

Id. at 200 (citations omitted).

In Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939), the Court found that the agreement requirement was fulfilled by the knowing participation in a plan which, if successful, would serve to restrain trade. *Id.* at 226-27. Six years later, the Court acknowledged that proscribed combinations could be implied as well as expressed, when they condemned a cooperative membership scheme restraining trade in news. Associated Press v. United States, 326 U.S. 1, 15 (1945). When confronted with a system of resale price maintenance in 1960, the Court stated that "whether an unlawful combination or conspiracy is proved is to be judged by what the parties actually did rather than by the words they used." United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960). Specifically, the proposed test was declared to be as follows:

> When the manufacturer's actions, as here, go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices . . . he has put together a combination in violation of the Sherman Act.

Id. In Albrecht v. Herald Co., 390 U.S. 145, 149, 150 n.6 (1968), the Court interpreted this statement as prohibiting a variety of implied combinations. *See generally* Turner, *supra* note 40.

contention of Holiday Inns, which argued that since the decision to grant or deny a franchise application was exclusively a decision of the corporation, there was no combination or conspiracy.[42] In analyzing this defense, the court relied upon the following language from *Interstate Circuit, Inc. v. United States*:[43]

> "Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act."[44]

Consequently, the court concluded that the standard radius letter policy was equivalent to a "conspiracy to allocate territories horizontally."[45] The court also held that the conduct of Holiday Inns and Fleck, the Newark Airport franchisee, in denying AMI's application, constituted a separate local conspiracy which isolated Fleck from potential competition.[46]

Having subjected Holiday Inns' radius letter policy to a rule of reason analysis, the district court found that, considered individually, the policy was equivalent to both a general conspiracy to restrain trade in violation of the Sherman Act and a regional conspiracy to protect one franchisee. Concerning the general conspiracy, it appears that it was the practice itself, irrespective of the frequency of resulting restraints, which was held to constitute the illegal scheme.[47]

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42 Holiday Inns contended that its refusals to grant AMI's franchise application were unilateral since it "does not treat objections by franchisees to applications as 'vetoes' and it did not . . . treat such objections to the [AMI] application as such." Defendant's Post-Trial Memorandum at 13. One of the factors which was allegedly taken into consideration by the Franchise Committee was that there was an insufficient amount of business to justify two Holiday Inns in the proposed area. *Id.* at 56-57. The court stated in its findings of fact, however, that negotiations between Holiday Inns and Fleck had indicated a mutual belief "that the Newark Airport area could support a second Holiday Inn." 365 F. Supp. at 1087.

43 306 U.S. 208 (1939).

44 365 F. Supp. at 1090-91 (quoting from Interstate Circuit, Inc. v. United States, 306 U.S. 208, 227 (1939)).

45 365 F. Supp. at 1090. As the factual basis for this general conspiracy, the court stated that dissident franchisees knew that their objections "would result in the inability of the Franchise Committee to grant a franchise application." *Id. See also* United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960).

46 365 F. Supp. at 1091. This alternative holding was primarily based upon the actual facts surrounding the denial of AMI's request. The court found that the belief by both Fleck and Holiday Inns that the Newark Airport area could sustain additional facilities was inconsistent with the contention that the rejection of AMI's application was solely unilateral. *See* note 42 *supra*.

47 *See* note 39 *supra*. The Supreme Court has stated: "Section 1 of the [Sherman] Act outlaws unreasonable restraints on interstate commerce, regardless of the amount of the commerce affected." United States v. Yellow Cab Co., 332 U.S. 218, 225 (1947). *See also*

The second aspect of the Holiday Inns system evaluated by the court was the "parent company town" policy.[48] The contested practice concerned Holiday Inns' treatment of franchise applications for the areas in which the parent company owned or operated its own inns.[49] Although not included in the original complaint, this policy was challenged by AMI as a contributing factor in the horizontal territorial allocation allegedly resulting from the overall scheme.[50]

The general practice whereby a franchisor also acts as his own franchisee is ordinarily accepted as a valid form of vertical integration[51] or dual distribution.[52] A problem arises, however, when the principal in such a situation acts in its capacity as franchisor in order to protect itself as franchisee from threatened competition.[53] These were the cir-

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Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 213 (1959) (a group boycott found illegal even though it affected only one retail store).

Cases prior to the instant decision have also shown that particular procedures of soliciting or taking action upon comments from those in a horizontal position relative to a potential competitor constitute an illegal combination or conspiracy. *See, e.g.*, United States v. Topco Associates, Inc., 405 U.S. 596 (1972) (see note 36 *supra* and accompanying text); United States v. General Motors Corp., 384 U.S. 127, 144-45 (1966) (solicitation of, and assistance by, dealers constituted "joint action"); Ford Motor Co. v. Webster's Auto Sales, Inc., 361 F.2d 874, 879-80 (1st Cir. 1966) (action taken by manufacturer on complaint of dealer constituted "agreement"). None of these decisions, however, have been interpreted as condemning a general investigatory policy involving separate and distinct franchisor and its franchisees.

48 *See* note 8 *supra*.

49 365 F. Supp. at 1091. *See* note 24 *supra*.

50 365 F. Supp. at 1076-77. *See also* Plaintiff's Post-Trial Memorandum at 16-19, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973) [hereinafter cited as Plaintiff's Post-Trial Memorandum].

51 Pollock, *supra* note 2, at 113. The concept of franchising oneself has been proposed as a means of escaping the Supreme Court's prohibition in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). Pollock, *supra* note 2, at 113; Pollock, *supra* note 35, at 609-10.

52 Bork, *supra* note 29, at 470. The general validity of this type of arrangement was noted as recently as May, 1973:

> The Department of Justice does not believe that franchisors should be prohibited from attempting to distribute their products through company-owned outlets.

Remarks by Barry Grossman, Chief of the Evaluation Section of the Antitrust Div. of the Dep't of Justice, Sixth Annual Legal and Gov't Affairs Symposium of the Int'l Franchise Ass'n, May 17, 1973, in 5 TRADE REG. REP. ¶ 50,171, at 55,305 (1973). For a collection of statements reporting both the advantages and disadvantages of dual distribution schemes, see *Hearings on S. 1842, S. 1843 and S. 1844 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 2d Sess., pt. 2 (1966).

53 *See* Grossman, *supra* note 52, at 55,307. In the instant situation, AMI complained that Holiday Inns was using its power to reject franchise applications in order to isolate the company-owned inns from the threat of potential competition. Plaintiff's Post-Trial Memorandum at 19.

cumstances presented to the Supreme Court in *United States v. McKesson & Robbins, Inc.*,[54] an action involving charges of price-fixing.

The question in *McKesson* was whether a manufacturer-wholesaler should lose the "fair trade" exemption from the Sherman Act which had been granted to manufacturers in certain industries.[55] In ruling that McKesson's market position as a wholesaler rendered the statutes inapplicable, the Court stated that "without regard to categories or labels, the crucial inquiry is whether the contracting parties compete with each other."[56] Invoking this reasoning, the district court in *Holiday Inns* looked past the "franchisor-franchisee" classifications and found that the two parties were actually in direct competition.[57] Having already found a general practice of refusing to grant applications in parent company towns,[58] the court concluded that the policy was equivalent to a horizontal allocation of territories, effectively reducing intra-brand competition.[59]

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54 351 U.S. 305 (1956). McKesson & Robbins, Inc. was both a manufacturer of drug products and the largest drug wholesaler in the United States. Its products were distributed either directly to retailers or to independent wholesalers, some of whom were in competition with McKesson's wholesaling division.

55 The Miller-Tydings Act of 1937, ch. 690, tit. VIII, 50 Stat. 693 (codified as the two provisos of 1, 15 U.S.C.), and the McGuire Act of 1952, ch. 745, § 2, 66 Stat. 632 (codified in section 45(a), 15 U.S.C.), exempt certain retail price maintenance contracts (fair trade agreements) from the prohibitions of the antitrust laws when the agreement involves particular branded or trade-marked goods. Each of these exemptions specifically does not include agreements "between persons, firms, or corporations in competition with each other." 15 U.S.C. § 1 (1970); 15 U.S.C. § 45(a)(1)(5) (1970).

McKesson, who already had fair trade agreements with retailers of its products, announced a policy of refusing to deal with competing wholesalers who would not enter into a similar fair trade contract with the manufacturer. 351 U.S. at 307. The Court was then forced to determine whether McKesson had waived these exemptions by operating at both levels. *Id.* at 312-13.

56 351 U.S. at 313.

57 365 F. Supp. at 1092. Holiday Inns, when in the position of owning or operating its own inn, was functioning at the same market level as its independent franchisees.

58 *Id.* at 1091. Kemmons Wilson, Chairman of the Board and founder of Holiday Inns, Inc., testified as follows:

"Q. Are you familiar with any policy whereby Holiday Inns will turn down applications because the company is operating its own Inn in those towns?
A. Yes. I mean, we generally—if we are operating in a town—will not sell franchises, but we have done it.
Q. There have been exceptions, but the general practice . . .
A. . . . The general practice is we don't do it . . . ."

Id. at 1079 (quoting from Deposition of Kemmons Wilson at 63, American Motor Inns, Inc. v. Holiday Inns, Inc., 365 F. Supp. 1073 (D.N.J. 1973). Additionally, a request for a franchise in a parent company town necessitated not only the approval of the Franchise Committee, but also that of the Executive Committee, which effectively placed a further requirement in the application procedure. 365 F. Supp. at 1080-81.

59 365 F. Supp. at 1097. The intra-brand competition was defined as competition "in the market of 'Holiday Inn motel beds.'" *Id.* at 1088 n.4.

This particular aspect of the Holiday Inns system, however, was found to be outside the proscriptions of the Sherman Act.[60] Since the policy was entirely unilateral, it lacked the element of agreement necessary for a finding of illegality.[61] The court here rejected an argument based upon the now-famous dictum in *Albrecht v. Herald Co.*[62] that AMI's "repeated acquiescence" in situations involving parent company towns was sufficient to constitute an illegal combination.[63] The present scheme was found to be easily distinguishable from that which was criticized in *Albrecht* due to the inherent differences between a franchising system and a price-fixing agreement.[64] The action of Holi-

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See also Hobart Bros. Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894, 899 (5th Cir. 1973) (manufacturer-wholesaler's territorial restraints on independent distributor "resulted in a horizontal territorial allocation"); Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711, 719 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 (2d Cir. 1969) (manufacturer-distributor's written sales agreement resulted in an illegal territorial restraint).

For a general discussion of the per se illegality of horizontal restraints of trade, see note 37 *supra*.

60 365 F. Supp. at 1093.

61 The court distinguished the findings of illegality in *Hobart* and *Interphoto* on the basis of their written agreements. In each of those cases the challenged practice became apparent from an examination of the particular contract in question, while in the instant situation "the parent company town policy cannot be found explicitly or implicitly in the franchise agreement." *Id. See generally* Greenberg, *Unilateral Refusals to Deal*, 42 ANTITRUST L.J. 305 (1973).

62 390 U.S. 145 (1968).

63 365 F. Supp. at 1093; *see* 390 U.S. at 150 n.6. In this footnote, the *Albrecht* Court presented in hypothetical form its interpretation of the type of action which would be sufficient to show an illegal combination under United States v. Parke, Davis & Co., 362 U.S. 29 (1960). The note reads in pertinent part:

> Under *Parke, Davis* petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price.

390 U.S. at 150 n.6.

The theory by which this type of situation is found to constitute an illegal combination in the context of a refusal to deal was aptly phrased by one commentator six years prior to the *Albrecht* decision:

> [W]hile there may well be merit in protecting the right of the trader to deal with those whom he chooses as a general rule, there is also merit in not letting him refuse to deal for any reason that suits him in those situations where refusal induces compliance in a course of action that offends public policy.

Turner, *supra* note 40, at 689. The criticism in each of these quoted passages appears to be directed at the element of coercion. *See, e.g.*, McMackin v. Schwinn Bicycle Co., 1972 Trade Cas. ¶ 74,220, at 93,020 (N.D. Ill. 1972) (where the court found that the "acceptance of a burdensome tie-in by an appreciable number of buyers within the market permits an inference of coercion").

64 365 F. Supp. at 1093. The court recognized that in the hypothetical situation proposed in *Albrecht*, the acquiescing party had another alternative available since he could have continued to sell at a different price. AMI, however, "could not have taken it upon itself to build a Holiday Inn even if [Holiday Inns] had no parent company town policy." *Id.*

day Inns in accepting or refusing franchise applications in this context was found by the court to be solely that of the parent company.[65] The parent company town policy, considered individually, was therefore regarded as being outside the prohibition of the antitrust laws even though it served to restrict competition.

The non-Holiday Inn clause, the third contested element in the licensing system, currently appears in all franchising agreements used by Holiday Inns.[66] Its inclusion in the written contracts eliminates the necessity of proving the existence of any type of combination or conspiracy.[67] In order to assess the validity of such a clause, a court need only subject the clause and its effect on the market to a rule of reason analysis.[68]

This provision was challenged by AMI as being an illegal restraint since it has the effect of precluding one who operates even a single Holiday Inn from opening another type of hotel or motel anywhere in the United States.[69] The non-Holiday Inn clause may also serve to totally prohibit a potential competitor from entering a particular geographical market. As a result of Holiday Inns' practice of enforcing the clause,[70] if the application of a franchisee seeking to operate an additional inn is rejected, he is also barred from constructing any other hotel-motel at the proposed site. It was also found that no other hotel-motel chain imposed an equivalent restriction on its franchisees.[71]

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65 Unlike the practice of sending radius letters, which involved independent franchisees, this decision was made exclusively by the corporation. *See* notes 38 & 39 *supra*.

66 365 F. Supp. at 1093. The clause is quoted in note 17 *supra*.

67 365 F. Supp. at 1093. If this clause did not explicitly appear in the agreement, it would be necessary to prove it to be either implicitly included in the contract or the end result of a combination or conspiracy. *Id. See also* 15 U.S.C. § 1 (1970).

68 365 F. Supp. at 1093. The following procedure for evaluating the reasonableness of a challenged restraint was enunciated by the Supreme Court in the context of a suit to enjoin a corporate merger:

> In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, *whether the action springs from business requirements or purpose to monopolize*, the probable development of the industry, consumer demands, and other characteristics of the market.

United States v. Columbia Steel Co., 334 U.S. 495, 527 (1948) (emphasis added); *accord*, Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 615 (1953) (using the same standards to analyze a tying arrangement). *See also* note 28 *supra*.

69 Plaintiff's Post-Trial Memorandum at 24.

70 365 F. Supp. at 1082.

71 The court found that Sheraton Inns, Inc., Hilton Inns, Inc., and Howard Johnson Motor Lodges all use a variety of computerized reservation systems, yet none of these corporations have a contract clause similar to that of Holiday Inns. Each of these other

In an attempt to justify the use of the restrictive clause, Holiday Inns emphasized the necessity of the successful functioning of its computerized referral system. Known as the "Holidex system," the referral network enables travelers at one Holiday Inn to place and confirm reservations at other inns which are part of the chain. Holidex has been a major factor in the corporation's rapid expansion and Holiday Inns expressed fear that the elimination of the non-Holiday Inn clause would result in widespread abuse of the referral system and eventual damage to the entire chain.[72]

When a franchisor includes a restrictive clause similar to the one used by Holiday Inns in the franchise agreement for the purpose of protecting a particular aspect of its business, the clause must appear in the least restrictive form possible.[73] This doctrine was expressed by Justice Brennan in *White Motor Co. v. United States*,[74] where the Supreme Court was confronted with a franchising system allocating specific territories to distributors:

> [T]he problem is not simply whether some justification can be found, but whether the restraint so justified is more restrictive than necessary, or excessively anticompetitive, when viewed in light of the extenuating interests.[75]

In evaluating the Holidex system as the proposed justification for the non-Holiday Inn clause, the court found that its restrictions unduly exceeded what was necessary for the protection of the referral system.

Specifically, the court first compared Holiday Inns' restrictive clause with the practices used by other hotel-motel chains having some type of referral system, and determined that the clause was a greater

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hotel-motel chains allows its operators to become affiliated with non-parent company establishments. *Id.* at 1094.

72 Defendant's Post-Trial Memorandum at 17-23. This is a franchisee-supported computerized system inter-connecting all operating inns. As examples of possible abuses of the system, Holiday Inns theorized that a franchisee receiving reservations through Holidex could refer customers to a non-Holiday Inn, either within the same area, or in a different region. 365 F. Supp. at 1094.

73 *See* RESTATEMENT OF CONTRACTS § 515(a) (1932); Comment, *supra* note 4, at 1022. *See also* Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964); Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331 (2d Cir.), *cert. denied*, 345 U.S. 994 (1953).

74 372 U.S. 253 (1963).

75 *Id.* at 270 (Brennan, J., concurring) (footnote omitted). A similar limitation on permissible controls was noted by the Court of Appeals for the Sixth Circuit shortly after the enactment of section 1. United States v. Addyston Pipe & Steel Co., 85 F. 271, 282-83 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) (finding of illegality is required where restraint "exceeds the necessity presented by the main purpose of the contract"). *Accord*, Alders v. AFA Corp., 1973 Trade Cas. ¶ 74,355, at 93,655 (S.D. Fla. Jan. 22, 1973) ("the covenant must be no broader than necessary").

restraint than those used by the other organizations.[76] The effects and alleged purpose of the clause were then evaluated with respect to a second provision appearing within the Holiday Inns agreements. This additional clause required all franchisees to use their "best efforts" to promote the success of the entire Holiday Inns system.[77] As a result of the court's finding that other chains employ less restrictive techniques and that the "best efforts" clause by itself would sufficiently serve the asserted motive for the non-Holiday Inn clause, the court declared that "[a] restraint on trade as drastic as the non-Holiday Inn clause was and is unnecessary."[78] Since it was not the least restrictive alternative, the clause constituted a contract unreasonably in restraint of trade and thus violated the Sherman Act.

One aspect of this problem which was not specifically discussed by the court involved Holiday Inns' attempt, through the non-Holiday Inn clause, to totally eliminate any possibility of franchisee abuse of the Holidex system, by removing any financial incentive for unauthorized use of the system. By prohibiting any affiliation with a non-Holiday Inn, enforcement of the clause would remove the temptation which might otherwise arise for the franchisee to misuse the referral network in order to divert guests to non-Holiday Inns in which the franchisee also has an interest.[79] Perhaps motivated by the less restrictive solutions to the abuse problem employed by other motel chains, the court declined to discuss this defense of the non-Holiday Inn clause.[80]

In an alternative analysis of the non-Holiday Inn clause, the court assumed the validity of Holiday Inns' contention that the clause was

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[76] 365 F. Supp. at 1094. Hilton Inns, Inc. requires only that a franchisee operating another motel have written consent from Hilton. This consent has always been granted. Howard Johnson Motor Lodges prohibits such actions within a 25 mile radius of one of its locations, and even this requirement may be waived. Sheraton Inns, Inc. has no restrictions; however, a clause in the contract requires intra-chain referrals. *Id.* at 1083-84.

[77] This second clause reads in pertinent part:

> "Licensee does further covenant and agree . . . to use every reasonable means to encourage use of 'Holiday Inns' on a national basis by the traveling public."

Id. at 1082 (quoting from Holiday Inns Standard Licensing Agreement). The court found that this provision would not only satisfy the alleged purpose behind the non-Holiday Inn clause, but would also be far less restrictive. *Id.* at 1094.

[78] *Id.* at 1094.

[79] Holiday Inns presented an interesting example in its attempt to justify the clause. One franchisee owned a Holiday Inn where he accepted referrals from other inns in the chain, yet he referred his own guests to independent motels under his control, rather than to others in the Holiday Inns System. Defendant's Post-Trial Memorandum at 16-17.

[80] 365 F. Supp. at 1094. Alternatives such as territorial prohibitions with a realistic possibility of waiver (Howard Johnson Motor Lodges), or reliance on a good faith provision (Sheraton Inns, Inc.) would seem to be far less objectionable and more easily justified than the non-Holiday Inn clause. *See* note 76 *supra*.

merely the equivalent of a valid form of exclusive dealing.[81] Ordinarily, exclusive dealing situations are challenged under section 3 of the Clayton Act.[82] The prohibitions of section 3, however, are applicable only to goods and not to services.[83] The court recognized that the Clayton test is more rigorous than the section 1 rule of reason analysis, and acknowledged that an exclusive dealing arrangement which survives the standard under the Clayton Act could not be in violation of the Sherman Act.[84] In analyzing the defendant's contention that the non-Holiday Inn clause was a valid exclusive dealing arrangement, the court decided to subject the practice to recognized section 3 tests. If the restriction should fail the section 3 scrutiny, the court concluded that the arrangement must still be subjected to a rule of reason approach to determine its legality under section 1.[85] In this particular instance, the

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81 365 F. Supp. at 1094-95. An exclusive dealing contract has been defined as "[a] contract to sell within a certain territory goods of a specified kind to, or through the agency of, one person only." 14 S. WILLISTON, LAW OF CONTRACTS § 1644C, at 182 (3d ed. 1972). Such agreements are generally recognized as legitimate business arrangements. *Id. Accord,* RESTATEMENT OF CONTRACTS § 516(e) (1932).

In some situations, however, an exclusive dealing arrangement may constitute a violation of the Sherman Act. 14 S. WILLISTON, *supra* § 1653B, at 367 (where an exclusive agreement is given the alternative definition of "the practice by which a manufacturer or producer induces distributors to refrain from handling the line of a competitor" (footnote omitted)).

82 15 U.S.C. § 14 (1970). The statute provides in pertinent part:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods . . . or other commodities . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . or other commodities of a competitor or competitors of the lessor or seller, where the effect of such . . . agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

83 *Id. See* Hoerner, *Some Issues in Tying and Exclusive Dealing,* 38 U. CIN. L. REV. 233, 237 (1969) ("must be tangible personalty"); Comment, *supra* note 4, at 1027 n.97 ("does not cover situations involving land or services").

84 365 F. Supp. at 1095. An exclusive dealing contract, even if not unreasonable under a section 1 analysis, may be held to violate section 3 of the Clayton Act. Robinson, *Restraints on Trade and the Orderly Marketing of Goods,* 45 CORNELL L.Q. 254, 275 (1960). Occasionally, the prohibitions of these two statutes will be identical. 1 R. CALLMANN, *supra* note 30, § 15.3, at 331. The major distinguishing factor is the "extent to which an effect on competition must be shown before a violation will be found." Hoerner, *supra* note 83, at 235. *See also* McLaren, *Exclusive Dealing Arrangements,* in CONFERENCE ON THE ANTITRUST LAWS AND THE ATTORNEY GENERAL'S COMMITTEE REPORT 155 (J. Rahl & E. Zaidins ed. 1955) [hereinafter cited as CONFERENCE] (suggesting that a prosecutor's burden of proof is lower under the Clayton Act, since its prohibitions are stronger).

85 365 F. Supp. at 1095. In this manner, the court is actually only subjecting the clause to a section 1 analysis, while giving Holiday Inns the additional opportunity to justify the provision by allowing them to show its validity under a section 3 test. If it should fail under section 3, the final ruling would still be made according to the more lenient section 1 rule of reason approach.

court had already found the clause to be in violation of section 1. Should the practice be found invalid under the section 3 standards for an exclusive dealing arrangement, its predetermined illegality under the rule of reason analysis would illustrate its total incompatability with the antitrust laws.

In order to assess the validity of an exclusive dealing arrangement, it is necessary to examine the effect of the practice on the relevant market. Two of the most important Supreme Court cases involving exclusive dealing agreements, *Standard Oil Co. v. United States*[86] (*Standard Stations*) and *Tampa Electric Co. v. Nashville Coal Co.*,[87] express this requirement. In the former, the Court announced what is currently referred to as the "quantitative substantiality test" for exclusive arrangements when it stated:

> We conclude, therefore, that the qualifying clause of § 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected.[88]

In the more recent *Tampa Electric* case, the Court established guidelines to be followed in this determination. This procedure, known as the "qualitative substantiality test," was stated by the *Holiday Inns* court in the following terms:

> The guidelines to be followed are: definition of the line of commerce on the basis of the facts peculiar to the case; charting of the area of effective competition in the known line of commerce; finding foreclosure of a substantial share of the relevant market.[89]

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86 337 U.S. 293 (1949).

87 365 U.S. 320 (1961). *See also* FTC v. Brown Shoe Co., 384 U.S. 316, 321 (1966) (exclusive dealing agreement in franchising context found to conflict with the Sherman and Clayton Acts).

88 337 U.S. at 314. *See generally* 16H VON KALINOWSKI, *supra* note 37, § 64.04[2][b] (rev. 1972).

This test was the subject of major criticism by a committee who evaluated the state of the antitrust laws. REPORT, *supra* note 37, at 142; *accord*, Johnston, *Appraisal of the Report and its Major Recommendations*, in CONFERENCE, *supra* note 84, at 23; McLaren, CONFERENCE, *supra* note 84, at 153.

89 365 F. Supp. at 1095-96 (citing Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 327-28 (1961)). The first two guidelines are referred to as the relevant product market and the relevant geographical market. By stressing the necessity to "weigh the probable effect of the contract on the relevant area of effective competition," the Court was apparently attempting to avoid the same type of criticism as had been directed at *Standard Stations*. 365 U.S. at 329. Many courts have since followed this set of guidelines. *See* 14 S. WILLISTON, *supra* note 27, § 1659 at 471 n.11. *See generally* 16H VON KALINOWSKI, *supra* note 37, § 64.04[2][c] (rev. 1972).

For further discussions concerning the impact of *Tampa Electric* on exclusive dealerships, see Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CT. REV. 267; Comment, *Standards of Illegality Under Section 3 of the Clayton Act*, 59 MICH. L. REV. 1236 (1961).

The *Holiday Inns* court then applied these standards to the facts surrounding the instant controversy.[90]

By defining the relevant product market to be "national hotel-motel chains or referral groups," the court found that 14.7 percent of the market was foreclosed from competition by the non-Holiday Inn clause.[91] After comparing that figure with the 16 percent foreclosed in *Standard Stations*, the *Holiday Inns* court held that the clause, having already been found illegal under a straight section 1 analysis, would also violate section 1 if it were found to be an exclusive dealing arrangement.[92]

Having decided that both the radius letter policy used by Holiday Inns and the non-Holiday Inn clause violated section 1 of the Sherman Act, the court concluded that these practices and the permissible but restrictive parent company town policy, which individually lacked the requisite element of mutuality, had the cumulative effect of creating an overall system of horizontal allocation of territories.[93] The correct approach for evaluating such an all-encompassing scheme was suggested in *Continental Ore Co. v. Union Carbide & Carbon Corp.*,[94] where the Supreme Court stated:

> "[T]he character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole."[95]

When the three challenged aspects of the Holiday Inns system are put into the proper perspective in the overall scheme, so that each

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90 365 F. Supp. at 1096.

91 *Id.* This figure was achieved by determining the number of independent Holiday Inn franchisees and comparing it to the total number of operating hotels-motels that belong to the "29 largest hotel-motel systems utilizing national referrals." *Id.* at 1085. The court's reason for selecting this particular market definition lies in the assertions by Holiday Inns as to the importance of the Holidex system of referrals. Were the relevant market to be the entire hotel-motel industry, this figure would be only 1.6 percent. *Id.* at 1096 n.21.

Any attempt to measure market size in terms of percentages only is "risky." 1 R. CALLMANN, *supra* note 30, § 15.3(c)(6), at 373. The importance of the problem was stated to be that "[i]f the market is incorrectly defined, we can anticipate that the result will usually be likewise erroneous." Handler, *Twenty-Five Years of Antitrust (Twenty-Fifth Annual Antitrust Review)*, 73 COLUM. L. REV. 415, 453 (1973).

92 365 F. Supp. at 1097. The Court in *Standard Stations* found that Standard Oil's exclusive contracts involved 16 percent of the independent gasoline outlets in the relevant geographical market. 337 U.S. at 295. Based on this figure, the Court found those agreements to violate section 3 of the Clayton Act. *Id.* at 314. *See also* note 84 *supra*.

93 365 F. Supp. at 1098. See note 37 *supra* for a discussion of horizontal restraints.

94 370 U.S. 690 (1962).

95 *Id.* at 699 (quoting from American Tobacco Co. v. United States, 147 F.2d 93, 106 (6th Cir. 1944)).

franchisee is aware of the system's operation, the final result is a "combination and conspiracy to allocate territories horizontally, illegal per se."[96]

Due to the inherent rigidity of any per se rule, commentators are forecasting a decreasing application of the per se rule in future antitrust litigation.[97] One author has stated that a "per se rule is only supportable where the challenged arrangement has a pernicious effect on competition and lacks any redeeming virtue."[98] Another has suggested that territorial restrictive and exclusive franchises may actually allow for more intense competition.[99]

When a court is confronted with a business restraint challenged under section 1 of the Sherman Act, it would appear that all circumstances surrounding the restriction and the specific complaint should necessarily be examined. The *Holiday Inns* court, in its cumulative finding of per se illegality, seems to have been using that label merely as a means of classification, since it was not proposed until each element in the entire system had been thoroughly scrutinized under a rule of reason analysis. Because the finding of per se illegality was not announced until after a full trial, it had no procedural effect on the court's analysis and, therefore, serves merely to suggest a similarity to previous arrangements which were placed in an equivalent category.[100] Consequently, the district court's restrained use of this label tends to reinforce the theory that the utilization of the per se classification is on the decline.

Owing to the widespread use and rapid growth of service franchis-

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96 365 F. Supp. at 1098. The radius letter policy acted to restrain intra-brand competition, while the non-Holiday Inn clause restricted inter-brand competition. Additionally, each franchisee knew of these policies and their effects. *See* note 45 *supra* and text accompanying note 70 *supra*. With respect to the clause, the franchisees had requested that IAHI encourage its enforcement. 365 F. Supp. at 1082.

The franchisee's participation in the radius letter policy and the group's desire for stricter enforcement of the non-Holiday Inn clause tend to show their participation in the entire plan.

Four years ago, it was suggested in a hypothetical situation that a system such as Holiday Inns' would be condemned by the courts:

> A service franchise, which includes exclusive dealing and territorial or customer restrictions or both, would certainly present the court with ample reason to condemn it. Even if each of the provisions were not individually invalid, the restrictions in the aggregate might necessarily invalidate the franchise agreement.

Averill, *supra* note 2, at 74.

97 *See* Van Cise, *supra* note 29, at 1176. *See generally* note 29 *supra* (discussing criticism of per se rules).

98 Handler, *supra* note 91, at 423 (citing Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1968)). *See also* 14 S. WILLISTON, *supra* note 27, § 1650, at 336.

99 Robinson, *supra* note 84, at 267.

100 The system had already undergone a rule of reason test so that any evidentiary stigma carried with a per se condemnation was irrelevant.

ing,[101] the problem of overly restrictive franchising systems, such as the one found to be illegal by the district court in *Holiday Inns*, is attracting considerable attention. New forms of control are constantly being investigated by the Congress in order to insure that these industries do not violate established public policy.[102] On the other side of the controversy, however, it is contended that the success of franchising depends upon the use of various restrictions by the franchisor over his franchisees.[103] Despite disagreement over the particular types of improvement desired, both sides agree that definitive legislative guidelines are necessary in order to delineate the extent of permissibility in the utilization of restrictive clauses in franchising agreements.[104]

In the absence of such prescriptive legislation, expanding franchisors must thoroughly examine all relevant court decisions in order to determine the acceptable parameters of a projected licensing system. Two months after the *Holiday Inns* court rendered its decision, AMI and Holiday Inns announced a proposed merger,[105] apparently eliminating any likelihood of appeal. Consequently, the district court's opinion presents the growing service franchisor with two unresolved dilemmas. Although the invalidity of a totally prohibitive noncompetition clause is evident from the *Holiday Inns* decision, the ultimate boundary for permissible restrictions remains unclear. The second area of uncertainty concerns the extent to which a franchisor may confer with its operating franchisees with respect to license applications for additional outlets. If it should appear that the denial of a new application resulted from the objections of an established franchisee, the system may well be invalidated under the *Holiday Inns* court's formulation of the agreement requirement of the Sherman Act. In order to assure the validity of its licensing system, it will be necessary for service franchisors to remove overly restrictive clauses from their contracts and to avoid collaboration with existing franchisees on the propriety of

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101 *See, e.g.*, Defendant's Post-Trial Memorandum at 26 (64% rate of growth in number of motels in the country between 1965 and 1971); Post-Trial Memorandum of IAHI at 52-54 (statistics showing expansion of seven competing hotel-motel chains). *See generally* notes 1 & 2 *supra*.

102 *See, e.g., Hearings on Exclusive Territorial Allocation Legislation Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 92nd Cong., 1st & 2d Sess., pt. 1-2 (1972). *See also* Van Cise, *supra* note 29, at 1169.

103 Pollock, *supra* note 2, at 106-07.

104 *See, e.g.*, Baker, *supra* note 2, at 55,212; 6A A. CORBIN, CONTRACTS § 1402, at 184 (1962); Oppenheim, *supra* note 29, at 1244.

105 N.Y. Times, Nov. 4, 1973, at 95, col. 5; Wall St. Journal, Nov. 5, 1973, at 12, col. 2.

establishing additional facilities. By thus implicitly encouraging an increase in the number of application approvals, the *Holiday Inns* court has provided for further expansion and more intense competition in the field of service franchising.

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