Applying Antitrust Laws to Business Format Franchising Agreements

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I. INTRODUCTION

A. Background of the Study

1. The Success of Franchising in Business

Franchising has become one of the most interesting business practice phenomena in the past century. The growth of industries that have chosen this method of doing businesses has been incredible. In the United States (U.S.), revenues rose from $350 billion in 1980 to $529 billion in 1985.[1] At

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present, "[a]ccording to the International Franchise Association (IFA), franchising companies and their franchisees account for $1 trillion in annual U.S. retail sales."[2]

In the Philippines, "franchising sales [amount] to 1.2% of the Gross Domestic Product, and [represent] 15% of total retail sales."[3] Furthermore, home grown franchises have exhibited 31% growth.[4]

Franchising has likewise contributed to employment generation. In the U.S., franchising employs more than eight million people, a number that translates to around seven per cent of the country's total nonagricultural employment.[5]

Locally, franchising is expected to contribute to employment generation in the Philippines by as much as 15%.[6] As much as five million of these jobs are expected to be generated by food, fashion and entertainment, telecommunications, transport, and tourism.[7] These franchising opportunities "will be sourced from displaced employees, and retrenched executives from downsized organizations, retired senior executives, women who want to own business, graduates who cannot find high-paying jobs, and retiring professionals and workers."[8]

With the Overseas Contract Workers in particular, franchising offers a way out. It provides a venue where they can invest the savings they have accumulated from their occupations abroad. Franchising gives them the option of placing their hard earned money to a lasting business.

Cite as 56 ATENEO L.J. 300 (2011).

1. David J. Kaufmann, The Big Bang: How franchising became an economic powerhouse the world over, *available at* http://www.entrepreneur.com/magazine/entrepreneur/2004/january/66000.html (last accessed Aug. 31, 2011).
2. *Id.*
3. *RP Emerges as Franchise Hub,* MANILA BULL., July 13, 2007, *available at* http://www.mb.com.ph/node/23210 (last accessed Aug. 31, 2011).
4. Bernie Cahiles-Magkilat, *Local Franchises See 31% Growth,* MANILA BULL., July 2, 2007, *available at* http://www.mb.com.ph/node/21926 (last accessed Aug. 31, 2011).
5. Kaufmann, *supra* note 1.
6. Bernie Cahiles-Magkilat, *Franchising Seen to Create 15% More Jobs,* MANILA BULL., Sep. 24, 2005, *available at* http://www.mb.com.ph/node/140586 (last accessed Aug. 31, 2011).
7. *Id.*
8. *Id.*

Indeed, franchising has become one of the most popular methods of doing business.[9] One of its most common forms is food-service establishments, a form of franchising that started ever since McDonald's made its first franchise agreement with Ray Kroc.[10] Today, about "1,500 business-format franchise networks operate more than 320,000 franchised units in the [U.S.]."[11] They include retailers, hotels and motels, home improvement, maintenance, and technology.[12] Here in the Philippines, about 850 franchise concepts have been established, having the fourth biggest economic impact in the Asia-Pacific.[13]

Franchising has also served as an effective tool for facilitating technology transfers, particularly with the methods of doing business. As local franchisees learn from the business practices of foreign franchisors, they are also able to develop their own methods of doing business. Local franchisees can apply these developed methods in their other business endeavors and, with the franchisor's consent, in running the franchised business.

Another unique feature of the franchising business method is its ability to create long standing businesses. In fact, it has been observed that

> [w]hile the average rate of failure for new businesses is 65 percent within five years of inception, a recent study prepared by the IFA reveals that only 3 to 11 [%] of franchised units (varying by industry segment) suffer 'turnover' in any given year ('turnover' defined as closure of the unit or sale to a nonfranchised purchaser).[14]

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9. Mohd Amy Azhar Hj. Mohd Harif & Chee Hee Hoe, *The Financial and Non-Financial Elements in the Franchise Disclosure Document for a New Franchise System*, WORLD J. SOC. SCI., July 2011, at 16 (citing G. MIRANDA, FRANCHISING: AN OVERVIEW (1995)).
10. *See* RONALD D. MICHMAN & ALAN J. GRECO, RETAILING TRIUMPHS AND BLUNDERS: VICTIMS OF COMPETITION IN THE NEW AGE OF MARKETING MANAGEMENT 167-69 (1995).
11. Kaufmann, *supra* note 1. Internationally, "about 500 US franchise networks now have a global presence." *Id.* This includes McDonald's, 7-Eleven, Yum! Brands (A&W, KFC, Pizza Hut, Taco Bell), InterContinental Hotels Group (Holiday Inn and InterContinental Hotels & Resorts), Subway, Dunkin Donuts, and Krispy Kreme. *See, e.g.*, Kaufmann, *supra* note 1 & Cahiles-Magkilat, *Franchising Seen to Create 15% More Jobs*, *supra* note 6.

    Local businesses have also begun expanding to other countries. Cahiles-Magkilat, *supra* note 6. Examples are Bench, Penshoppe, Chowking, Jollibee, Island Souvenirs, Kamiseta, and Netopia. Franchising allowed these businesses to create market presence overseas without having to incur too many expenses.
12. *See generally* Entrepreneur, Franchises, *available at* http://www.entrepreneur.com/franchises/index.html (last accessed Aug. 31, 2011).
13. Cahiles-Magkilat, *Franchising Seen to Create 15% More Jobs*, *supra* note 6.
14. Kaufmann, *supra* note 1.

Particularly in the Philippines, "there has been a 90[%] success rate[ ] among first-time entrepreneurs who bought into business models that have reputable track records."[15]

As David Kaufmann puts it, "reality affirms what the statisticians tell us."[16] Franchising has been almost synonymous with fast food, and everyone can see that fast food is all around us. When looking for a place to eat, almost every person will think of a McDonald's, Jollibee, or Pizza Hut while deciding. According to Kaufmann, the reason for this is simple. Americans love recognized brands.[17] On that matter, the rest of the world, including Filipinos, is not far behind.[18]

In this Article, the Author finds it curious that the rapidly growing business method of franchising has remained unchecked by our government. Dr. Robert Justis, director of the International Franchise Forum, says that "[i]t is appropriate for any growing association to be under some form of regulation."[19]

Currently, the Intellectual Property Office applies the provisions of the Intellectual Property Code[20] on Voluntary Licensing of Technology Transfer Agreements to franchising agreements.[21] However, these provisions do not take into consideration the unique nature of business format franchising agreements. It is necessary that our laws, as mandated by the Constitution,[22] foster competition rather than unduly hamper it.

2. The Inadequacy of Antitrust Legislation

The purpose of antitrust laws is the reduction of activities that are harmful to competition in the market.[23] This is based on the belief that competition

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15. *RP emerges as franchise hub*, *supra* note 3.

16. Kaufmann, *supra* note 1.

17. *Id.*

18. *Id.*

19. Bernie Cahiles-Magkilat, *US Expert Urges Government Regulation of Franchising*, MANILA BULL., July 11, 2006, *available at* http://www.mb.com.ph /node/83104 (last accessed Aug. 31, 2011).

20. An Act Prescribing the Intellectual Property Code and Establishing the Intellectual Property Office, Providing For Its Powers and Functions, and For Other Purposes [INTELLECTUAL PROPERTY CODE], Republic Act No. 8293 (1997).

21. *Id.* §§ 85-92.

22. *See* PHIL. CONST. art. XII, § 19.

23. *See* MAHER M. DABAH, THE INTERNALISATION OF ANTITRUST POLICY 50 (2003).

breeds efficiency and that efficiency benefits the nation by better allocating resources.

Antitrust legislation has long been absent in Philippine laws, to the point that most people do not even know what it is. Curiously enough, no less than the Constitution mandates the State to foster competition and prevent restraints of trade.[24] The problem lies with the legislators that have hesitated to touch the topic due to its technical nature. Except few measly and ineffective provisions here and there, as will be discussed later in the Article, our statutory law is silent on the matter. Jurisprudence has also been scarce on the matter. This is in contrast to the rest of the countries in the Asia-Pacific Region. In this region, all the developed countries, along with some developing ones, have enjoyed quite a long history of antitrust policy and law themselves.[25]

The development of antitrust policies has also been observed outside the Asia-Pacific Region. Currently, there is a trend of coming up with antitrust legislation among different nations. The Philippines cannot distance itself from the rest of the world lest it become susceptible to the damaging effects of practices the rest of the world are already safeguarding themselves against.

Antitrust or competition law requires the prohibition of certain acts that are believed to be in restraint of trade, whether between players within the same or different levels of production. Thus, agreements between these players such as business format franchise agreements which fall within the latter of the two cases may run afoul to antitrust concepts. Contrary to this, our current antitrust laws are ambiguous as to what transactions may be considered "in restraint of trade." Hence, the enforcement of our statutes has been quite ineffective. It is necessary that these provisions be clarified and delineated to ensure proper enforcement. While a long line of jurisprudence on this delineation has already been developed in different legal jurisdictions, the Philippines is still governed by antitrust laws that were legislated long ago. Thus, a comprehensive inquiry on these cases must be done so that the Philippines can properly legislate standards that are in line with modern theory.

B. Statement of the Issue

24. PHIL. CONST. art. XII, § 19. ("The State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed.")

25. Pradeep S. Mehta, *Competition Policy in Developing Countries: An Asia-Pacific Perspective* (A Chapter in a Bulletin of the United Nations Economic and Social Commission for Asia and the Pacific on Sustainable Growth in Asia) 80, *available at* http://www.unescap.org/drpad/publication/bulletin%202002/ch7.pdf (last accessed Aug. 31, 2011). As of 2003, there were already at least 21 Asian countries that have enacted antitrust laws. *Id.* at 86.

Can business format franchise agreements require vertical restrictions in light of antitrust policies? This can be illustrated by answering the following questions:

(1) Whether or not franchisors can require their franchisees to follow (a) a minimum resale price and/or (b) a maximum resale price.

(2) Whether or not franchisors can require the franchisees to purchase other products from the franchisor as a condition in the franchise agreement.

(3) Whether or not franchisors can impose exclusive territorial restrictions and other non-price restrictions on the franchisees.

(4) Whether or not franchisors can require franchisees to exclusively deal with them.

C. Objectives of the Study

The main objective of the Article is to enlighten legislators to the intricacies of antitrust legislation, as well as the unique characteristics of franchising agreements, which cannot be appreciated by general principles that barely scratch the surface of the subject. This will be accomplished by looking at the long and rich history of antitrust theory and jurisprudence which have been tested, refined, and developed through time. Existing business concepts both in the field of franchising and antitrust will also aid in coming up with legislation that is in line with the realities of the modern business environment. After a consideration of all these concepts, past and present, the Author seeks to establish the best way to apply the degree of antitrust regulation to franchising practices.

Therefore, the final aim of this Article is the enactment of special rules in the field of franchising separate from a general law on antitrust. These special rules are aimed to answer the need of better supervision in the industry by truly appreciating the nature of Business Format Franchise Agreements while at the same time not overly regulating the practice to the point that the growth of the businesses using such method is stifled to the prejudice of our country's economy.

Incidentally, the Article also aims to provide a discussion on the different concepts of competition law, particularly vertical restraints, which have been comprehensively debated upon and refined by years of litigation arising from franchisor and franchisee disputes, so that the Philippines can avoid similar problems.

D. Significance of the Study

As mentioned, regulation of any growing industry is essential.[26] It is also important, however, that the regulation of an industry be proper for the said industry to grow. As it stands, there is an overwhelming silence in our statutory laws as to antitrust regulation of franchising practices. The only option, then, for our administrative officials, is to look to laws which were not enacted with this particular concept in mind. As a result, wrong standards are being used to determine what should be allowed and what should not be allowed.[27] If not for the saving exception clauses of these improper laws, a true business format franchise agreement may have never come into fruition under such law. This may have been hindering the growth and spread of this concept.

Ironically, in other countries, franchising concepts and antitrust laws frequently come into a clash, so much so that there are numerous divergent opinions and decisions on the matter. This has resulted in numerous conflicts and court cases between franchisors and franchisees in the 1970s and 1980s.[28] Even in the recent times, there is still disarray in franchise antitrust law.[29] Replacing an improperly applied law by another improperly applied law will just cause more problems. Unduly restricting the practice may undermine the purpose for which it was first developed. It must be stressed that a business format franchise agreement is, first and foremost, a business method or strategy, and just secondarily, a legal relation. If the latter takes precedence, the concept upon which the franchise agreement is based may lose the effectiveness that makes it so desirable.

Also, most business format franchises in the Philippines, such as McDonald's, Krispy Kreme, and Pizza Hut, are of foreign origins. These agreements are regulated by master franchises. Most of these foreign firms have extensive experience in creating agreements that will help them maneuver around the intricacies of antitrust regulations. We, on the other hand, having limited antitrust experience, may find ourselves at a disadvantage. We cannot shun away the reality that antitrust regulation is a worldwide phenomenon that is now reaching an international scale. To properly protect our businesses, we must take steps to ensure that competition in our market is properly protected.

By looking into the experiences of other countries, we can learn from their mistakes and avoid the years of litigation that they had to go through to get to where they are today.

26. Cahiles-Magkilat, *US Expert Urges Government Regulation of Franchising*, *supra* note 19.

27. *See generally* INTELLECTUAL PROPERTY CODE, §§ 85-92.

28. Kaufmann, *supra* note 1.

29. *See* Warren Grimes, Franchising — the vacuum of antitrust leadership, *available at* http://www.antitrustinstitute.org/node/10043 (last accessed Aug. 31, 2011).

E. Scope and Limitations

The Article includes a brief description of Voluntary Licensing of Technology Transfer Agreements,[30] the improper law being currently applied to franchise agreements to illustrate the former's inapplicability to the latter.

It also includes a discussion of the foundation of antitrust or competition law in the Philippine Constitution. An examination of sparse legislation that most closely approximates antitrust legislation is also included.

The Article will also take a look at the antitrust law in the U.S.. This includes an examination of the major laws on antitrust, such as the Sherman Antitrust Act[31] and the Clayton Antirust Act,[32] followed by a comprehensive analysis of the long line of jurisprudence on the subject matter. Specific emphasis will be placed on the different jurisprudential tests that affect the acceptability of resale price maintenance, tying agreements, and exclusivity contracts. This includes an inquiry as to what acts are covered by the vague description of "in restraint of trade."

Due to the absence of a discussion in our law as to what exactly is a business format franchise agreement, as well as different concepts as to its nature, elements, and characteristics, there is a need to look at the literature in the fields of business and economics involved in this type of franchise agreement.

It must be noted, however, that the discussion will be limited to the relationship between the franchisor and the franchisee. The Article will focus on the business, economic, and legal concepts involved in vertical restrictions. Other antitrust issues will not be discussed. Concepts involving the relationship of the franchisor and the franchisee which do not necessarily involve antitrust legislation shall not be included in the Article as well.

F. Organization of the Article

Due to the scarcity of discussion in our legal system on business format franchising agreements, the first part of the Article involves a comprehensive discussion of this concept. This begins with an attempt to define what the agreement really is. To this end, a definition will be sourced from business practices, economic theory, and foreign legislation. The Author will also attempt to discuss the elements of a business format franchising agreement and the duties and obligations that such an agreement entails. Thereafter, the Author will look into the different business and economic concepts in relation to the use of the method in conducting a business. This is followed

30. INTELLECTUAL PROPERTY CODE, §§ 85-92.

31. The Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1890) (U.S.).

32. Clayton Antitrust Act, 15 U.S.C. §§ 12-27 & 29 U.S.C. §§ 52-53 (1914) (U.S.).

by a review of all the laws that can be applied to such an agreement in the absence of a proper law on the matter.

The second part of the Article discusses the other part of the problem, namely, antitrust legislation. A comprehensive discussion of the field relevant to the topic is required. As noted, the Philippine legal system is also seriously lacking in this field. The discussion will begin by discussing the two major laws involved in the controversy, namely, the Sherman Antitrust Act and the Clayton Antitrust Act. The provisions of these Acts shall be broken down and analyzed in order to understand what antitrust law seeks to prohibit, why it seeks to prohibit what is being prohibited, and how it attempts to regulate. This involves looking into foreign legal opinions and treatises on the subject matter, as well as interpretations made by U.S. courts of the different provisions of the Acts.

Next, the Author will look into specific areas of conflict between the two concepts discussed in the first two parts of the Article. It will be grouped into three, namely resale price maintenance, tying agreements, and exclusivity agreements. The Author will then look at the different jurisprudential tests that have been used regarding the acceptability and non-acceptability of such practices in franchise agreements. The Author aims to analyze each test in order to recognize the advantages and disadvantages of each, taking into consideration the concepts that were looked into in the two previous parts in order to determine the rule that is best for the Philippines.

Finally, the Author, taking into careful consideration the concepts discussed and the outcome of the analysis made in the Article, will formulate special rules that can be included in a draft bill. The draft bill is envisioned to apply antitrust concepts in business format franchise agreements.

II. BUSINESS FORMAT FRANCHISING

Much is known about the franchising industry, but little is known about the franchising relationship itself. In this Section, the Author seeks to establish a better understanding of the franchising relationship.

A. What is Franchising?

One of the first steps in trying to understand something is to properly define it. Various legislations have provided different definitions of franchising. Since most of these legislations deal more with disclosure requirements rather than antitrust regulation, the Author will only focus on how these laws define franchising agreement.

In the U.S., the Federal Trade Commission defines franchising as:

> any continuing commercial relationship created by any arrangement or arrangements whereby:

(1) (i) (A) a person (hereinafter 'franchisee') offers, sells, or distributes to any person other than a 'franchisor' (as hereinafter defined), goods, commodities, or services which are:

(1) Identified by a trademark, service mark, trade name, advertising or other commercial symbol designating another person (hereinafter 'franchisor'); or

(2) Indirectly or directly required or advised to meet the quality standards prescribed by another person (hereinafter 'franchisor') where the franchisee operates under a name using the trademark, service mark, tradename, advertising or other commercial symbol designating the franchisor; and

(B) (1) The franchisor exerts or has authority to exert a significant degree of control over the franchisee's method of operation, including but not limited to, the franchisee's business organization, promotional activities, management, marketing plan or business affairs; or

(2) The franchisor gives significant assistance to the franchisee in the latter's method of operation, including, but not limited to, the franchisee's business organization, management, marketing plan, promotional activities, or business affairs; *Provided, however*, That assistance in the franchisee's promotional activities shall not, in the absence of assistance in other areas of the franchisee's method of operation, constitute significant assistance; or

(ii) (A) A person (hereinafter 'franchisee') offers, sells, or distributes to any person other than a 'franchisor' (as hereinafter defined), goods, commodities, or services which are:

(1) Supplied by another person (hereinafter 'franchisor'), or

(2) Supplied by a third person (e.g., a supplier) with whom the franchisee is directly or indirectly required to do business by another person (hereinafter 'franchisor'); or

(3) Supplied by a third person (e.g., a supplier) with whom the franchisee is directly or indirectly advised to do business by another person (hereinafter 'franchisor') where such third person is affiliated with the franchisor; and

(B) The franchisor:

(1) Secures for the franchisee retail outlets or accounts for said goods, commodities, or services; or

(2) Secures for the franchisee locations or sites for vending machines, rack displays, or any other product sales display used by the franchisee in the offering, sale, or distribution of said goods, commodities, or services; or

(3) Provides to the franchisee the services of a person able to secure the retail outlets, accounts, sites or locations referred to in paragraph (a) (1) (ii) (B) (1) and (2) above; and

(2) The franchisee is required as a condition of obtaining or commencing the franchise operation to make a payment or a commitment to pay to the franchisor, or to a person affiliated with the franchisor.[33]

Some states have also come up with their own franchising legislations. American Franchising Attorney, Andrew J. Sherman, classifies these definitions into several groups.[34]

The first is the Majority State Definition followed by the states of California, Illinois, Indiana, Maryland, Michigan, North Dakota, Oregon, Rhode Island, and Wisconsin. It provides for three essential elements:

(1) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor.

(2) The operation of the franchisee's business is substantially associated with the franchisor's trademark or other commercial symbol designating the franchisor or its affiliate.

(3) The franchisee is required to pay a fee.[35]

The Minority State Definition followed by the states of Hawaii, Minnesota, South Dakota, and Washington has the following elements:

(1) The franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name or other commercial symbol or related characteristics.

(2) The franchisor and franchisee have a common interest in the marketing of goods and services.

(3) The franchisee pays a fee.[36]

The State of New York has its own elements. These elements are:

(1) The franchisor is paid a fee by the franchisee.

(2) Either essentially associated with the franchisor's trademark or the franchisee operates under a marketing plan or system prescribed in substantial part by the franchisor.[37]

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33. 16 C.F.R. § 436.2 (a) (1986) (U.S.).

34. ANDREW J. SHERMAN, FRANCHISING AND LICENSING: TWO POWERFUL WAYS TO GROW YOUR BUSINESS IN ANY ECONOMY 66-67 (3d ed. 2003).

35. *Id.* at 66.

36. *Id.*

37. *Id.*

The State of Virginia also has its own definition with the following elements:

(1) A franchisee is granted the right to engage in the business of offering or distributing goods or services at retail under a marketing plan or system prescribed in substantial part by a franchisor.

(2) The franchisee's business is substantially associated with the franchisor's trademark.[38]

As for European countries, the European Commission had previously defined a franchise as "a package of industrial or intellectual property rights relating to trademarks, trade names, shop signs, utility models, designs, copyrights, know-how, or patents, to be exploited for the resale of goods or the provision of services to end users."[39]

Looking at the common denominators in these definitions, we begin to see the parties involved in a franchising agreement: the franchisor and the franchisee. The franchisor is the one who possesses a product or service recognized under a particular trademark. He offers the franchisee the right to operate the business of offering the franchisor's product or service that is associated with the trademark under a marketing plan or method of operation prescribed in substantial part by the franchisor. Additionally, the franchisor provides the franchisee commercial and technical assistance as the latter learns the process of offering the product or service. The franchisee, in turn, pays a fee for such right to use the franchise.

B. What is "Business Format" Franchising?

At this juncture, it is important to distinguish "business format" franchising from other forms of franchising. There are two major forms of franchising: product or trade franchising and business format franchising.[40] The essential difference between the two is the business relationship that they create.

In product or trade franchising, the core of the relationship is the product being distributed. What the franchisee gets is the right to sell the product manufactured by the franchisor under its trademark. The franchisor usually leaves the franchisee, for the most part, to its own devices. The franchisor derives profit mostly from the product it supplies to its franchisee.[41]

On the other hand, in business format franchising, what is being given to the franchisee is not just a simple product but an entire business format, that

38. *Id.* at 66-67.

39. Commission Regulation 4087/88, art. 1 (3) (a), 1988 O.J. (L 359) 46, 48 (EC).

40. ROBERT R. BETANCOURT, THE ECONOMICS OF RETAILING AND DISTRIBUTION 191 (2004).

41. *See* BRADLEY J. SUGARS, SUCCESSFUL FRANCHISING 16-17 (2006).

is, a system of doing business. As such, aside from the product and trademark, the franchisee also acquires the business's "goodwill, product and marketing knowledge, intellectual property, marketing and promotion power, ongoing training, quality control, operational policies and procedures, research and development, assistance, guidance, support, and bulk buying power."[42] After all, the franchisor is expected to have tested and perfected its business format in giving the highest possibility of business success. The franchisor is not just concerned about the fact that the product is sold, he is also concerned with the manner the business is being operated. Hence, the franchisor needs to ensure that his business format is being carried out properly. The business relationship in business format franchising, then, is much closer and interdependent. The franchisor and franchisee coordinates in making key business decisions. Profit is derived by the franchisor from the initial franchising fee and the royalties based on the sales of the franchisee.[43]

C. Advantages of Franchising

There are many reasons why business format franchising has become a popular mode of doing business.

1. Franchisor

a. Harnessing Intellectual Capital

For the franchisor, the practice of franchising is a means of leveraging intellectual capital.[44] Rather than using the business solely to enhance other physical assets and to make the company more competitive, it can be used as an asset in itself that is capable of generating profits. This is important in today's economy where a company needs to be efficient and must be able to utilize as much of its resources as possible. Hence, while a successful business can earn substantial profits from its operations, it can further augment its earnings by franchising its system into another branch. This is especially useful for small scale businesses which have not reached the stage of expansion. These businesses can make use of a single franchise unit to earn extra income.[45]

b. Reduced Risk of Expansion

It is also a means of expanding one's market. Unlike most growth strategies, however, the franchisor is able to do so with less risk and less investment

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42. SHERMAN, *supra* note 34, at 12.

43. *Id.*

44. *See generally* SHERMAN, *supra* note 34, at 3.

45. *Id.*

since the franchisee undertakes the investment in the business venture. Hence, the franchisor is able to enter into different ventures without having to worry about raising finances. This means that the franchisor can increase its presence with relative ease and minimal cost.[46] Although it is the franchisee that mostly benefits from the profits of a particular venture, the franchisor benefits from the operations of the franchisee because of the increase market penetration of the business. The trademark of the franchisor becomes more valuable as its goodwill is built up through the operations of its franchisees.[47]

c. Effective Micromanagement

From an administrative point of view, franchising also lightens the burden of the franchisor in managing and monitoring his business ventures. Although the business is being run under the business format of the franchisor, it is, in the end, the business of the franchisee. A franchisee, who has invested so much of his own capital to the business venture, will have the incentive to act for its best interest in a way that no employee, no matter how responsible or loyal, can measure up to. Each franchised unit is autonomous to a certain extent. This means that the franchisor will have to worry about fewer administration expenses when starting a venture. This aspect also assists in the ability of the franchisor to venture into areas that would have been previously too costly to maintain due to the distance.[48]

2. Franchisee

a. Recognizable Brand and Goodwill

For the franchisee, the most prominent benefit is the ability to operate under the trademark and goodwill of the franchisor.[49] The franchisor is expected to have operated the business successfully. As such, the franchisor has acquired some customer loyalty.[50] Thus, the franchisee enters into the business with a recognizable brand already. It saves him the trouble of having to spend years building one on his own.[51]

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46. Craig R. Tractenberg, *Legal Aspects of Franchising*, *in* FRANCHISING: CONCEPTS AND CASES 44-45 (2005).

47. *See* SHERMAN, *supra* note 34, at 12.

48. *Id.*

49. *See* Kurt Strasser, *Big Macs And Radio Shacks: Antitrust Policy For Business Format Franchises*, 27 ARIZ. L. REV. 341, 346-48 (1985).

50. *Id.*

51. *Id.*

b. Turn-Key Business

The franchisee also benefits from the knowhow of the franchisor. The franchisor has operated the same business before successfully. In using the business format that the franchisor used, the franchisee reduces the risk of business failure. The franchisee is able to bypass the stage of trying different methods. He is able to use those which are most efficient. The franchised business is described as a "turn-key operation" where the franchisee can just turn the key and everything starts operating on its own.[52] In addition to this, the franchisee receives substantial support from the franchisor, as a specialist, in terms of training, advice, and market information. These are things that the franchisee will not have access to as an independent enterprise.[53]

c. Economies of Scale

Another advantage is economies of scale. The franchisor, if given control over the buying power of its franchisees, can negotiate the best possible prices.[54] Because of this, franchisees can enjoy lowered wholesale prices.

Moreover, the concentration of control in the franchisor over certain aspects, such as advertising, allows franchisees to venture into large scale activities.[55] A franchisor, by charging advertising fees, can distribute the costs of marketing the brand in a unified marketing program among the different franchisees. This gives the franchisees the ability to collectively afford more expensive advertising forms such as television commercials. They are also able to increase the pervasiveness of their marketing efforts, something that is hard to achieve with advertisements that are very limited due to budget constraints.[56]

D. Characteristics of the Franchisor–Franchisee Relationship

A franchising agreement essentially creates a continuing working relationship. It is this relationship that regulators must keep in mind in creating rules. Most U.S. franchising regulations center on pre-sale disclosure requirements. However, there has been little discussion on the regulation of the franchising relationship itself.[57] It is the purpose of this Section to provide a proper understanding of the relationship between the franchisor and the franchisee.

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52. SUGARS, *supra* note 41, at 17.

53. Strasser, *supra* note 49, at 347.

54. *Id.*

55. *See generally* Strasser, *supra* note 49, at 347.

56. Strasser, *supra* note 49, at 348-49.

57. Byron E. Fox & Henry C. Su, *Franchise Regulation — Solutions in Search of Problems?*, 20 OKLA. CITY U. L. REV. 241, 264-68 (1995).

1. Common Clauses in Business Format Franchise Agreements

Franchising essentially begins with a contract, the source of the obligations between the franchisor and franchisee. While parties are generally free to stipulate any term they want, common patterns have been observed in franchising agreements. In a report to the U.S. Senate, Urban B. Ozanne and Shelby D. Hunt compiled a list of the most common clauses that appear on franchising contracts. Among them are clauses on termination, royalties, insurance, duration, franchise fees, transfer of the business, training, operation standards, right to inspection, trademarks, auditing, enforcement procedures, separability, non-competition, physical layout, trade secrets, inheritance, agency status, operating manuals, territory, venue, hours, advertising, construction, site selection, management consultation, start-up date, alterations, lease, sign specifications, employees, arbitration, pricing, performance deposits, self-employment, and renewal fees.[58]

Gillian Hadfield makes a few observations on the frequency of these contract clauses. First, franchising contracts deal with every minute detail of the operation.[59] Second, most of the clauses deal with the obligations of the franchisee.[60] This is compared to the franchisor's obligations which usually extend only to training and advertising.[61] Some do not even extend to ongoing management support. Third, a lot of the clauses pertain to the protection of the trademark, which Hadfield concludes to mean that the primary interest of the contracts is the franchisor's property rights.[62] Fourth, the contracts regulate a lot of aspects of termination of the relationship.[63] Lastly, the franchisor generally has no obligation to improve upon the business format.[64] The franchisor also commands much discretion as to the operation of the system and may alter it in any manner it so chooses.[65] Additionally, she describes franchising contracts as incomplete. They are essentially "long-term-standard form contracts."[66] They regulate working

58. Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 939-42 (1990) (citing Senate Select Comm. On Small Business (Urban B. Ozanne & Shelby D. Hunt), 92D Cong., *Report Prepared For The Small Business Administration: The Economic Effects Of Franchising* (Comm. Print 1971)).

59. *Id.* at 943.

60. *Id.*

61. *Id.*

62. *Id.* at 943-44.

63. *Id.* at 944.

64. Hadfield, *supra* note 58, at 944.

65. *Id.*

66. *Id.* at 946.

relationship that could extend to a number of years.[67] It is impossible for them to account for each and every possible scenario that they might encounter. Hence, it is necessary for the courts to step in and interpret the contract from time to time.[68]

2. Franchising as a Business Relationship

In order to fully understand the relationship and overcome the incompleteness of the contract, one must not merely look at the law between the parties but also at the nature of the working relationship of the parties.

a. Trade-Offs

One way of looking at the relationship is by observing the trade-offs between the franchisor and the franchisee. There are two extreme relationships that the franchisor and the franchisee can have. The first is employment where the franchisor would have enjoyed both ownership and control. The other is distributorship where both ownership and control of the business is divided between the two.[69] Each has its own advantages. In ownership, the franchisor, being the owner, would have solely enjoyed the profits from the sale of the product. In distributorship, the franchisor does not have to incur so many administrative costs.[70] Franchising is a combination of the two. Regarding control, the relationship shifts towards employment. Regarding ownership and profits from sales, the relationship shifts towards distributorship. The franchisor relinquishes ownership and retains control. The franchisee retains ownership and relinquishes control.[71]

b. Conflicting Interests

Another way of describing the business relationship between franchisor and franchisee is one of conflicting interests.[72]

As mentioned earlier, franchisors enter into the relationship as a means of expanding their business.[73] Outside of the franchising relationship is the relationship between the firm and its customers. Thus, franchisors need to ensure the quality of the product or service at each outlet. They need to

67. *Id.*

68. *Id.* at 947.

69. Hadfield, *supra* note 58, at 931.

70. *Id.*

71. *Id.* at 932.

72. *Id.* at 949.

73. *Id.*

train their franchisees and protect their trade secrets.[74] Customers generally do not consider whether they are visiting a franchised or company outlet. It is all the same to them. Hence, substandard service in one outlet reflects badly upon the entire brand. This means that the franchisor is susceptible to free-riding practices of the franchisees.[75]

Unlike the franchisor whose focus is expansion, the franchisee is just concerned about the business that he is operating. Thus, while the franchisor is concerned about market presence and building the brand's goodwill, the franchisee only wishes for its outlet to be as profitable as possible so that he may recover the investments he has made into it. Hence, there is much temptation for the latter to offer substandard service in order to maintain a profitable margin to the detriment of the trademark.[76]

The problem for franchisees stems from the fact that they undertake the capital investment in the venture. There are usually two types of costs: fixed or overhead costs and variable costs. If the fixed cost cannot be recovered should the franchisee leave the market, it is generally referred to as a sunk cost.[77] Sunk costs put the franchisee at a disadvantage. For example, if a business can only generate enough revenue to cover the variable costs, the franchisee can just sell his fixed assets and leave the business. If he is unable to recover the cost of the fixed assets, he will be compelled to stay until he can recover his investments even though he is not profiting. The franchisor, therefore, may try to take the opportunity and force the franchisee to incur sunk costs, even though it may not necessarily be a legitimate business expense, in order to make the franchisee stay.[78]

c. Dependency

As mentioned, the motivation for the franchisee is the prospect of a ready-to-operate business. The typical franchisee has no or little business experience, especially in the field he is starting a business in. There is an element of dependency in the relationship of the franchisor and franchisee.[79] The franchisee is expected to follow the operational rules and regulations set forth by the franchisor. This is justified by the proposition that the franchisor has tested and perfected its business format. The franchisor has become a seasoned professional in the business and is in the best position to determine

74. *Id.*

75. Hadfield, *supra* note 58, at 950.

76. *Id.*

77. *Id.* at 951.

78. *Id.* at 952.

79. *Id.* at 961-62.

how to properly run the business. Being the inexperienced one, nothing is required from the franchisee but to follow the rules strictly.[80]

Note, however, that the franchisee's dependency and inexperience does not last forever. The franchisor and the franchisee go through a number of different changes in their relationship as it progresses. In the beginning, the franchisee is significantly dependent on the franchisor. The franchisor spends a lot of time assisting and training the franchisee at this crucial time. The franchisee is happy with all the support and attention he is getting.

Once the franchisee gets used to the mechanics of handling the funds of the business, he starts to recognize the part of his revenue that goes to the franchisor. He then starts wondering whether he is truly getting a return on what he is paying the franchisor for. At this point, the franchisee will tend to think that the success of the business is solely because of the time and the effort he puts in.

As his experience further grows, the franchisee will start to question the policies and restrictions being imposed on him by the franchisor. This is the stage where most litigation begins to occur and where the franchisee considers leaving the franchise with the belief that he is better off managing his own business. The franchisee can get past this stage by communicating his grievances to the franchisor and coming into a genuine discussion with the latter to solve the problems between them. The franchisor has to be open to the inputs of his franchisees. Ideally, this will all end with the franchisor and franchisee cooperating with each other for the betterment of the franchise.[81]

d. Intimacy

Many authors have come up with different metaphors concerning the franchisor-franchisee relationship. Some have called it as one akin to that of a parent and child.[82] Others have compared it to that of a conductor and his orchestra.[83] Some even used a coach and his team.[84] All this reflects the intimate relationship that must exist between the two in order to be successful. The franchisee entrusts his capital to the franchisor's significant control. The franchisor also entrusts the one asset of his business: the business

80. *Id.* at 963.

81. Greg Nathan, *The Six Stages of Franchise Relationships, in* FRANCHISING: CONCEPTS AND CASES (2005).

82. *See, e.g.*, SHERMAN, *supra* note 34, at 16.

83. *Id.*

84. *Id.*

goodwill to the franchisee. Every successful franchise relationship is built on trust and cooperation.[85]

Franchising is a unique relationship. It pools together strangers with divergent interests and expects them to cooperate and trust each other. They are recognized as parts of one system, uniform in all respects, but are expected to compete against each other. Franchisees are told that the success of the business essentially depends on them but are rarely given control over it. If the law is expected to pick up where the franchisor and franchisees left off, then it needs to understand what this creature is and how it operates, especially since it is a relatively new concept that is unique in all respects.

Regulation of franchising should not be done piecemeal as much as possible. Franchising involves a system of interrelated provisions. If regulation prohibits key aspects of the relationship, then the entire system will fall apart and there will be no incentive for anyone to enter into such an arrangement. Analysis should therefore consist of looking at the entire system and not just of individual prohibitions. That is why legislators should be especially wary of the dangers of using *per se* rules that are based on assumptions on specific provisions.[86]

III. ANTITRUST

Competition is good for the economy. This idea was put forth by Adam Smith in his well-known work, "An Inquiry into the Nature and Causes of the Wealth of Nations."[87] He theorizes that each person in a market will do what is in his own best interest.[88] Hence, each buyer will strive to look for the most value he can get for his money.[89] Sellers that do not provide the best value for the lowest price will lose customers. This provides an incentive for sellers to allocate their resources in such a way as to be able to produce as much output with what resources they have and with as little waste as possible. Resources will be used more efficiently and the nation's output will increase. This is known as perfect competition.[90]

Because of this, Adam Smith believed that there is no need to regulate the economy. The market will always move into its most efficient allocation.

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85. David J. Kaufmann, *The Genesis and Growth of Franchising, in* FRANCHISING: CONCEPTS AND CASES 16-17 (2005).

86. *See* Strasser, *supra* note 49.

87. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).

88. *Id.* at 237.

89. *Id.* at 287-88.

90. *See* BERNARDO M. VILLEGAS, GUIDE TO ECONOMICS FOR FILIPINOS 282 (6th ed. 2001) & WALTER NICHOLSON, MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS 336 (9th ed. 2005).

It is always guided by an "invisible hand."[91] Hence, he surmised that governments adopt a "laissez faire" attitude and generally leave businesses to govern the markets themselves.[92]

However, this has proven not to be the case. A lot of criticism have been leveled at the perfect competition scenario, that it rarely exists.[93] There are other factors to be considered such as monopolization in markets, externalities, and public goods.[94]

Regarding the first, firms in markets never tend to have equal market power.[95] Sometimes a firm can have more or even all of the market power. When a firm has all, the market is considered to be a monopoly.[96] When market power resides in a small group of firms, it is considered an oligopoly.[97] Monopoly power usually exists when there are barriers to entry of other firms in the market.[98] In the technical sense, there is a barrier to entry when a firm can produce at a lower cost only when it is producing high quantities of the product.[99] Other firms are prevented from entering since they have to start by producing in small quantities at first.[100] As a result, they will incur higher costs than the dominant firm and will not be able to compete with the latter's prices.[101] Barriers to entry can occur from legislation.[102] One legal concept that does that is patents, which offer protection to persons or firms that develop inventions.[103] This is, of course, not to say that these concepts are bad, only to say that these inhibit competition in its purest sense.[104]

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91. SMITH, *supra* note 87, at 288.

92. *See* VILLEGAS, *supra* note 90, at 283 & NICHOLSON, *supra* note 90, at 357.

93. *See, e.g.*, MICHELLE CINI & LEE MCGOWAN, COMPETITION POLICY IN THE EUROPEAN UNION 2 (1998); IS THERE PROGRESS IN ECONOMICS? KNOWLEDGE, TRUTH AND THE HISTORY OF ECONOMIC THOUGHT 26 (Stephan Boehm, et al. eds., 2002); & Kotaro Suzumura, *Competition, Welfare, and Competition Policy*, *in* ADVANCES IN PUBLIC ECONOMICS: UTILITY, CHOICE AND WELFARE 1-15, 2 (2005).

94. NICHOLSON, *supra* note 90, at 367-68.

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. NICHOLSON, *supra* note 90, at 367-68.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.* at 367-68 & 385-86.

Second, there are other factors that affect the costs of firms that the market price does not illustrate.[105] These are called externalities.[106] A prominent example of externalities is environmental considerations.[107] When a firm pollutes, it causes damage to third parties.[108] These social costs are not reflected in the market price.[109] Hence, resources will not be allocated properly.[110]

Third, there are goods that are hard to profit from. These are called public goods. Public goods are those that are nonexclusive and nonrivalrous. A good is nonexclusive if it is not easy to exclude other people from consuming the good. A good is nonrivalrous if other people can consume additional units of the good without any additional cost to the producer. One good example is road construction. If a firm undertakes the construction of roads, all persons will be able to enjoy it, not just the people the firm is doing it for. Additional people can also enjoy the road at no extra cost to the firm once it has already finished the project. That is why public goods such as the construction of roads are usually undertaken by the government whose goal is not the generation of profits but the provision of the public goods to the general community.[111]

Another problem with the perfect competition model is the ideal, rather than realistic, assumptions it makes. Foremost among these is the assumption that individuals are rational thinkers. It assumes that their choices are complete, transitive, and stable. They are complete in that they know whether they prefer one choice to another. They are transitive in that their preferences will always be consistent as they are assumed to have perfect information. They are stable in that their preferences will not change with small changes in the choices. However, this is not necessarily true. Individuals have a tendency to be indecisive at times. They are also subject to uncertainties in their decisions and very rarely have perfect information. Most individuals also cannot tell how much a thing needs to change before the individual's preference is affected. All of these mitigate the conclusions reached by the perfect competition model. Moreover, civilization has developed certain social norms and public policies that cannot just be ignored for reasons of economic efficiency.[112] In the Philippines, for

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105. *Id.*

106. NICHOLSON, *supra* note 90, at 368 & 586.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 368 & 597.

112. *See generally* PHILLIP AREEDA & LOUIS KAPLOW, ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES 12-13 (4th ed. 1988).

example, we also adhere to the principles of social justice and national patrimony.[113]

Thus, we come to a problem. Competition has been shown to be ideal for efficient allocation of resources and economic development. However, the conditions required to foster perfect competition is highly unrealistic and very difficult to implement. This is where Antitrust or Competition Law steps in. On the one hand, there is the theoretical perfect competition model with its unrealistic assumptions and susceptibility for abuse. On the other, the government incurs great costs and attempts to nationalize the economy of the State at the possible cost of efficiency, freedom to enterprise, and susceptibility for corruption. What Antitrust Law does is to look at perfect competition as its goal and to correct as much of the market imperfections as it can in the hopes of allowing the economy to move more and more towards the ideal goal.[114]

A. United States

The U.S. has a long history of antitrust legislation and an even longer antitrust common law tradition. The first among the antitrust legislations in the U.S. was the Sherman Antitrust Act in 1890. Sections 1 and 2 of the Act provides:

> § 1. Trusts, etc., in restraint of trade illegal; penalty
>
> 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. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000[.00] if a corporation, or, if any other person, $1,000,000[.00], or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.
>
> § 2. Monopolizing trade a felony; penalty
>
> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,00[.00] if a corporation, or, if any other person, $1,000,000[.00], or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.[115]

Other than efficiency, the purposes of the U.S. Congress in enacting antitrust statutes were "consumer interests in lower prices (perhaps at the

113. *See* PHIL. CONST. arts. XII & XIII.

114. AREEDA & KAPLOW, *supra* note 112, at 14.

115. Sherman Antitrust Act, §§ 1 & 2.

expense of productive efficiency), the political and social values of dispersed control over economic resources, multiple choices for producers and consumers free of the arbitrary dictates of monopolies or cartels, equal opportunity, and 'fairness' in economic dealings."[116] The Statute, at that time, did not give any meaning as to what can be considered "in restraint of trade." The Sherman Antitrust Act can be seen less as a prohibitive statute and more as a general authority to "use what common-law courts usually do: to use customary techniques of judicial reasoning, consider the reasoning and results of other common-law courts, and develop, refine, and innovate in the dynamic common-law tradition."[117]

The next legislation to follow was the Clayton Antitrust Act in 1914. Section 3 of the Act provides:

> 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, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the [U.S.] or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the [U.S.], or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.[118]

The reason for the enactment of the Clayton Antitrust Act was the dissatisfaction of the public at large with the vagueness of the Sherman Antitrust Act as well as the lack of its enforcement.[119] The Clayton Antitrust Act made sharper definitions as to what conduct was regarded as in restraint of trade.[120] That was especially useful to vertical restraints as the courts tended to focus more on horizontal restraints. The Clayton Antitrust Act was enacted the same year as the Federal Trade Commission Act[121] which addressed the other clamor for a trade commission that can focus on enforcing antitrust statutes.

B. European Community

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116. AREEDA & KAPLOW, *supra* note 112, at 56.

117. *Id.* at 51.

118. 15 U.S.C. § 14.

119 AREEDA & KAPLOW, *supra* note 112, at 59-61.

120. *Id.*

121. Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (2006) (U.S.).

In 1957, several European States organized themselves under the Treaty Establishing the European Economic Community[122] into a singular cooperative body. The treaty provided for certain regulations on commerce by member States including Competition Law. Article 85 of the Treaty reads:

> (1) The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
>
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
>
> (b) limit or control production, markets, technical development, or investment;
>
> (c) share markets or sources of supply;
>
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
>
> (2) Any agreements or decisions prohibited pursuant to this article shall be automatically void.
>
> (3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
>
> — any agreement or category of agreements between undertakings,
>
> — any decision or category of decisions by associations of undertakings,
>
> — any concerted practice or category of concerted practices,
>
> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
>
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

122. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 3 [hereinafter TEEC].

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.[123]

The purpose of the provisions on competition in the Treaty was to implement the goals of forming a closer union between the States. In order to do that, they resolved to eliminate the barriers to trade and obstacles to fair competition.[124]

C. Philippines

Antitrust in the Philippines has generally been regarded as non-existent and thus, not worthy of attention.

Ironically, the Constitution, no less, provides directives to enact antitrust statutes. Article II, Section 20 of the Constitution declares that "[t]he State recognizes the indispensable role of the private sector, encourages private enterprise, and provides incentives to needed investments."[125] Under this policy, it is recognized that the Government must not undertake the regulation of the economy. In order for the development of our economy to ensue, the Government should instead encourage private enterprise. This means facilitating the efficient functioning of the market.

However, the Constitution does not end there. In Article XII, the Constitution enumerates the economic goals of the State, namely:

> Section 1. The goals of the national economy are a more equitable distribution of opportunities, income, and wealth; a sustained increase in the amount of goods and services produced by the nation for the benefit of the people; and an expanding productivity as the key to raising the quality of life for all, especially the under-privileged.
>
> The State shall promote industrialization and full employment based on sound agricultural development and agrarian reform, through industries that make full and efficient use of human and natural resources, and which are competitive in both domestic and foreign markets. However, the State shall protect Filipino enterprises against unfair foreign competition and trade practices.[126]

Obviously, the drafters of the Constitution believed that our industries should be competitive, the first signs of antitrust language. It was also recognized that unfair competition can result from our foreign relations and that the Filipinos must be protected from it. Commissioner Bernardo M. Villegas did say that "the word 'unfair' in Section 1 does not partake of any

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123. *Id.* art. 85.

124. *Id.* pmbl.

125. PHIL. CONST. art. II, § 20.

126. PHIL. CONST. art. XII, § 1.

unique economic or legal interpretation[,]" meaning that the State can declare anything that hurts Filipino businesses as unfair.[127]

The Constitution further expounds on the economic policies of the State in Article XII, Section 19 where it states that "[t]he State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed."[128] Thus, unlike Article II, Section 20 and Article XII, Section 1, Article XII, Section 19 gives a much clearer mandate by the Constitution for antitrust legislation to be enacted. Therefore:

> The provision is a statement of public policy on monopolies and on combinations in restraint of trade. Section 19 is anti-trust in history and spirit. It espouses competition. Only competition which is fair can release the creative forces of the market. Competition underlies the provision. The objective of anti-trust law is 'to assure a competitive economy based upon the belief that through competition producers will strive to satisfy consumer wants at the lowest price with the sacrifice of the fewest resources. Competition among producers allows consumers to bid for goods and services and, thus, matches their desire with the society's opportunity costs.' Additionally, there is reliance upon the operation of the 'market' system (free enterprise) to decide what shall be produced, how resources shall be allocated in the production process and to whom various products will be distributed. The market system relies on the consumer to decide what and how shall be produced, and on competition, among producers who will manufacture it.[129]

The legislature enacted Article 186 of the Revised Penal Code as follows:

> Article 186. Monopolies and combinations in restraint of trade. — The penalty of prision correccional in its minimum period or a fine ranging from 200 to 6,000 pesos, or both, shall be imposed upon:
>
> (1) Any person who shall enter into any contract or agreement or shall take part in any conspiracy or combination in the form of a trust or otherwise, in restraint of trade or commerce to prevent by artificial means free competition in the market.
>
> ...
>
> If the offense mentioned in this article affects any food substance, motor fuel or lubricants, or other articles of prime necessity; the penalty shall be that of prision mayor in its maximum and medium periods, it being

127. JOAQUIN G. BERNAS, S.J., THE 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES: A COMMENTARY 1176 (2009 ed.) (citing IV RECORD OF THE CONSTITUTIONAL COMMISSION 216).

128. PHIL. CONST. art. XII. § 19.

129. BERNAS, *supra* note 127, at 1233 (citing Energy Regulatory Board v. Court of Appeals, 357 SCRA 30 (2001)).

> sufficient for the imposition thereof that the initial steps have been taken toward carrying out the purposes of the combination.
>
> Any property possessed under any contract or by any combination mentioned in the preceding paragraphs, and being the subject thereof, shall be forfeited to the Government of the Philippines.
>
> Whenever any of the offenses described above is committed by a corporation or association, the president and each one of the directors or managers of said corporation or association or its agents or representative in the Philippines in case of a foreign corporation or association, who shall have knowingly permitted or failed to prevent the commission of such offenses, shall be held liable as principals thereof.[130]

It is noticeable at the outset that Article 186 of the Revised Penal Code adopts the wording of the Sherman Antitrust Act. However, unlike the Sherman Antitrust Act whose vagueness has been supplemented by judicial decisions under the common law system of the U.S., Article 186 is harder to supplement under the civil law system of the Philippines. This is not to say that Article 186 has had no application. It has been applied to a certain extent by the Supreme Court in a case that held R.A. No. 8180 or the "Act Deregulating the Downstream Oil Industry and For Other Purpose[s]" unconstitutional,[131] and in a case that held valid an amendment in a corporation's by-laws that made a stockholder ineligible to become a director if he be the director of another rival company.[132]

The Legislature also enacted Article 28 of the Civil Code. Article 28 provides that "[u]nfair competition in agricultural, commercial or industrial enterprises or in labor through the use of force, intimidation, deceit, machination or any other unjust, oppressive or highhanded method shall give rise to a right of action by the person who thereby suffers damage."[133]

The Code Commission in enacting the provision stated that "[d]emocracy becomes a veritable mockery if any person or group of persons by any unjust or highhanded method may deprive others of a fair chance to engage in business or earn a living."[134] Thus, "[w]henever competition was suppresse[d] because of a monopoly, the competition that was so suppressed

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130. An Act Revising the Penal Code and Other Penal Laws [REVISED PENAL CODE], Act No. 3815, art. 186 (1930).

131. *See* Tatad v. Secretary of the Department of Energy, 281 SCRA 330 (1997).

132. *See* Gokongwei, Jr. v. Securities Exchange Commission, 89 SCRA 336 (1979).

133. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, art. 27 (1949).

134. TIMOTEO B. AQUINO, TORTS AND DAMAGES 824 (2d ed. 2005) (citing *Report of the Code Commission*, at 31).

can file an action for damages under Articles 19, 20, 21, and 27 of the Civil Code."[135]

The Intellectual Property Code also contains provisions that seek to regulate anti-competitive behavior. In its section on voluntary licensing of technology transfer arrangements, the Code provides that it aims "to encourage the transfer and dissemination of technology, prevent or control practices and conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition and trade"[136] Technology Transfer Arrangements are

> contracts or agreements involving the transfer of systematic knowledge for the manufacture of a product, the application of a process, or rendering of a service including management contracts; and the transfer, assignment or licensing of all forms of intellectual property rights, including licensing of computer software except computer software developed for [the] mass market.[137]

Business format franchising, being the transfer of the business format or system, is included in the definition. The Code, in Section 87, enumerates certain types of agreements that it prohibits to be put in technology transfer agreements, namely:

> 87.1. Those which impose upon the licensee the obligation to acquire from a specific source capital goods, intermediate products, raw materials, and other technologies, or of permanently employing personnel indicated by the licensor;
>
> 87.2. Those pursuant to which the licensor reserves the right to fix the sale or resale prices of the products manufactured on the basis of the license;
>
> 87.3. Those that contain restrictions regarding the volume and structure of production;
>
> 87.4. Those that prohibit the use of competitive technologies in a non-exclusive technology transfer agreement;
>
> 87.5. Those that establish a full or partial purchase option in favor of the licensor;
>
> 87.6. Those that obligate the licensee to transfer for free to the licensor the inventions or improvements that may be obtained through the use of the licensed technology;
>
> 87.7. Those that require payment of royalties to the owners of patents for patents which are not used;

135. *Id.* at 829.

136. INTELLECTUAL PROPERTY CODE, § 85.

137. *Id.* § 4.2.

87.8. Those that prohibit the licensee to export the licensed product unless justified for the protection of the legitimate interest of the licensor such as exports to countries where exclusive licenses to manufacture and/or distribute the licensed product(s) have already been granted;

87.9. Those which restrict the use of the technology supplied after the expiration of the technology transfer arrangement, except in cases of early termination of the technology transfer arrangement due to reason(s) attributable to the licensee;

87.10. Those which require payments for patents and other industrial property rights after their expiration, termination arrangement;

87.11. Those which require that the technology recipient shall not contest the validity of any of the patents of the technology supplier;

87.12. Those which restrict the research and development activities of the licensee designed to absorb and adapt the transferred technology to local conditions or to initiate research and development programs in connection with new products, processes or equipment;

87.13. Those which prevent the licensee from adapting the imported technology to local conditions, or introducing innovation to it, as long as it does not impair the quality standards prescribed by the licensor;

87.14. Those which exempt the licensor for liability for non-fulfillment of his responsibilities under the technology transfer arrangement and/or liability arising from third party suits brought about by the use of the licensed product or the licensed technology; and

87.15. Other clauses with equivalent effects.[138]

Exceptions to these prohibitions can only be attained if the firm can show that they have

> exceptional or meritorious cases where substantial benefits will accrue to the economy, such as high technology content, increase in foreign exchange earnings, employment generation, regional dispersal of industries and/or substitution with or use of local raw materials, or in the case of Board of Investments, registered companies with pioneer status.[139]

Looking at these provisions in light of the discussion on the nature of the franchising agreement and the relationship it creates, certain conflicts become readily apparent. The Code tries to make up for it by providing

138. *Id.* § 87.

139. *Id.* § 91.

exception from the prohibition if the applicant can prove that "substantial benefits will accrue to the economy, such as high technology content, increase in foreign exchange earnings, employment generation, regional dispersal of industries and/or substitution with or use of local raw materials, or in the case of Board of Investments, registered companies with pioneer status."[140] For the purpose of this Article, we focus on vertical restraints.

IV. VERTICAL RESTRAINTS

Vertical restraints, or restraints on vertical relationships, tend to receive less attention in antitrust discussion than horizontal restraints. Vertical relationships are those that pertain to firms in different levels of production of a product or service such as that between a supplier and distributor, as compared to horizontal relationships which pertain to those on the same level of production such as rival firms.[141] Business format franchising agreements, for one, form vertical relationships. Most of the materials used by franchisees are sourced from the franchisor such as the secret sauces and the equipment.

Franchising is replete with restrictions imposed by the franchisor on the franchisee. These are vertical restrictions, some of which could come in conflict with the antitrust or competition law principles mentioned earlier in the Article. This Section is a query on the application of antitrust laws to vertical restrictions such as franchising agreements.

Horizontal restraints are the poster children of antitrust legislation and the latter finds relatively easier application to the former. In this light, vertical arrangement must be distinguished from horizontal ones.

First, firms in vertical arrangements usually have a justifiable reason for collaborating, as compared to firms in horizontal arrangements which usually are in competition with each other and have generally no business making agreements. No one would expect every firm to produce from raw materials, package, market, and distribute a product all by itself.[142]

Second, vertical arrangements do not generally expand market power. Horizontal arrangements result in a combination of the market power of the firms coming in agreement.[143]

Third, vertical arrangements do not necessarily hinder the goals of antitrust legislation. For example, it may be used as a legitimate tool to

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140. *Id.*

141. *See* AREEDA & KAPLOW, *supra* note 112, at 625.

142. *See* Jean Wegman Burns, *Rethinking the "Agreement" Element in Vertical Antitrust Restraints,* 51 OHIO ST. L.J. 1, 10 (1990).

143. *Id.* at 11.

correct free-riding and quality assurance problems as will be discussed later.[144]

Lastly, vertical arrangements do not generally fit the concept of conspiracies usually associated with antitrust. While in horizontal arrangements, two firms usually come into agreement for their common good, vertical arrangements are usually producer conditions imposed on their distributors. Thus, the latter does not usually share a unity of purpose with the former.[145]

A. Pro-competitive Theories of Vertical Restraints

While traditionally, vertical restraints have been caught up with its horizontal brethren, recent studies have begun to show that they have pro-competitive uses. Among the greatest contributors to modern antitrust theory, namely the pro-competitive aspects of vertical restraints, is the Chicago School of Economics, which infused economic theory into the discussion.

There are several characteristics that define the Chicago way of thinking. The Chicago School uses an application of price theory and the perfect competition model, although not sticking to a strict adherence to it.[146] It also makes use of empirical evidence in the form of statistical data and case studies to study the efficiency of its rules.[147] Some of these uses are listed below.

1. Intrabrand versus Interbrand Competition

One of the cornerstones of vertical restraints advocacy is the argument that while vertical restraints tend to restrict intrabrand competition, or competition between dealers of the same brand, it promotes interbrand competition or competition between dealers of different brands.[148] The difference between interbrand and intrabrand cost cutting is the quality, promotion, information, and services that are lost on the latter.

In interbrand cost cutting, if the franchisee does not provide the services, no one will. Thus, the product will not get sold. In intrabrand cost-cutting, on the other hand, every franchisee will just expect to free ride on someone who will provide these services and no one will end up doing it. This kind of cannibalization compromises the ability to compete of the entire franchise in the interbrand arena.

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144. *Id.* at 11-13.

145. *Id.* at 13-16.

146. Joshua D. Wright, *The Roberts Court And The Chicago School Of Antitrust: The 2006 Term And Beyond*, COMPETITION POLY INT'L, Autumn 2007, at 33-35.

147. *Id.* at 35-37.

148. *See* Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (U.S.).

Thus, one of the essential advantages of competition which compels the State to step in through antitrust legislation is the ability to provide the maximum utility at the minimum price to customers. This effect from the efficient allocation of resources espoused by competition advocates will not occur if one of the players, especially if one of the bigger players is not competing at its most efficient.

2. Correcting Free Riding

The Free Riding Problem can be explained as follows. Vertical relationships usually create externalities. A vertical externality is created when part of the distributor's revenues go to the wholesaler as the latter's profit margin. The distributor is incurring a cost which has no bearing on the good or in its sale. This provides a disincentive to the distributor to provide promotional services. On the other hand, a horizontal externality is created between the distributors. A distributor may spend on pre-sale services such as a well-lit, air-conditioned showroom, properly trained staff, and a spacious lounge. However, nothing stops the customer from enjoying all the amenities provided by the distributor and then transferring to a discount place that does not offer these amenities but offers lower prices.

Lastly, an informational externality is created when a distributor spends on getting information on the product out to the public such as advertisements. There is no guarantee that the customer who was attracted will go to the one who spent on the advertisement. Vertical restrictions can be used in these instances to make distributors internalize these externalities.[149]

3. Quality Control

In relation to free riding, some franchisees tend to be very stingy when it comes to pre-sale expenses as their interest, unlike the franchisor's, is maximization of the branch's profits. This makes quality control one of the most important problems that franchisors need to address. Some might opt not to clean the branch everyday. Some might not hire the adequate amount of staff needed to serve customers. Some might not bother repairing the premises. Some might attempt to use substandard materials in making the product. These can all lead to the detriment of the business, the brand, and the goodwill.

Yet, the franchisee encounters the strong temptation to do all of these cost cutting measures, especially when he starts learning the financial aspect of the business. Vertical restraints can help in correcting this. For instance, resale price maintenance can be used to keep franchisees from cost cutting.

149. *See* Andy C. M. Chen & Keith N. Hylton, *Procompetitive Theories of Vertical Control*, 50 HASTINGS L.J. 573, 601-04 (1999).

Tying agreements and exclusive dealing can help the franchisor make sure that the franchisee is using materials that live up to the qualifications of the business format.[150]

4. Loss Leader Prevention

In franchising, the responsibility for marketing the format of the franchisees' uniform businesses usually belongs to the franchisor. When a customer approaches a franchisee's outlet, there is a strong association with the brand of the franchise and, thus, its goodwill. Remember that what franchisors offer is a complete business format that encompasses every minute detail of the business. Taking the example of food service establishments, when a customer walks into a fast food franchise such as McDonald's, he immediately gets a strong impression of the brand from the red and yellow colors, the golden arches that is their trademark, the distinctive smell of the food, the commercial he saw the other day, and even the wrappings the food is packaged in. These are the result of the market penetration of the different franchisees, the collective goodwill, and the marketing efforts of the franchisor. If other products are allowed to be retailed in the outlet, then they will be able to free ride off the efforts of the franchisor and other franchisees just by being offered in that establishment. Basically, the franchisor's efforts to attract customers are being used by the other products being retailed. This is especially detrimental if the other product is a competitor's product.[151]

B. American Case Doctrines

The U.S. has had a long and rich history in antitrust statutory and case law. It provides one of the best sources of discussions and debates on the topic. More than that, our own antitrust laws find their origins in the U.S.'s antitrust legislative history. Our Penal Code, which contains one of the first antitrust statutes in the Philippines, was enacted during the American occupation. Its wording has a striking resemblance to the Sherman Antitrust Act. In order to clarify the vague wording of our antitrust policy, a perusal of the interpretations done in the jurisdiction it came from is necessary.

1. The Rule of Reason Standard and the *Per Se* Illegality Rule

One of the first cases under the Sherman Antitrust Act was *Standard Oil Co. v. United States.*[152] It interpreted what combinations "in restraint of trade" were supposed to mean. The case involved a cartel of different companies. John D. Rockefeller, William Rockefeller, and some others in the crude oil

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150. *Id.* at 604-06.

151. *See* AREEDA & KAPLOW, *supra* note 112, at 772.

152. Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911) (U.S.).

production business decided to organize the Standard Oil Co. of Ohio and assigned all their respective businesses to it.[153] The Standard Oil Co. started attracting more and more firms in the crude oil business until it practically included as stockholders all but three or four firms in the State of Ohio which were in the crude oil business.[154] They subsequently created a trust in which the stock of the Standard Oil Co. of Ohio as well as those of other companies they had acquired in other states were assigned.[155] In effect, they put the trustees in control of the vast number of crude oil producing companies in the trust. The Supreme Court declared the act to be in violation of the Sherman Antitrust Act.[156] In interpreting the term "in restraint of trade," the Court stated:

> [A]s the contracts or acts embraced in the provision were not expressly defined, since the enumeration addressed itself simply to classes of acts, those classes being broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce or the subjects of such commerce, and thus caused any act done by any of the enumerated methods anywhere in the whole field of human activity to be illegal if in restraint of trade, it inevitably follows that the provision necessarily called for the exercise of judgment which required that some standard should be resorted to for the purpose of determining whether the prohibitions contained in the statute had or had not in any given case been violated. Thus, not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law, and in this country, in dealing with subjects of the character embraced by the statute, 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.[157]

The standard referred to in *Standard Oil* declared collaborations that unreasonably restrained trade as prohibited. This is now the accepted standard in determining the existence of antitrust violations. Under this rule,

> 'the fact finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.' ... Appropriate factors to take into account include 'specific information about the relevant business' and 'the restraint's history, nature, and effect.' ... Whether the businesses involved have market power is a further, significant consideration. ... In its design and function the rule distinguishes between restraints with anticompetitive

153. *Id.* at 31.

154. *Id.* at 32.

155. *Id.* at 33-34.

156. *Id.* at 79.

157. *Id.* at 60.

> effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest.[158]

There are, however, antitrust violations that the Court feels to be so manifestly anticompetitive that a prolonged discussion on a reasonableness that will never surface is deemed to be just a waste of time. In these instances, the Court simply opts to declare them *per se* illegal. *Per se* violations should only be used in situations when the court is convinced that the restraints "have such predictable and pernicious anticompetitive effect, and such limited potential for pro[-]competitive benefit."[159] It can be said that "[t]he *per se* treatment of price maintenance is justified because analysis alone, without the burden of a trial in each individual case, demonstrates that price floors [and other vertical restraints] are invariably harmful on balance."[160] After all, "[t]he question ... is not whether dictation of maximum prices is ever illegal, but whether it is *always* illegal."[161]

2. Resale Price Maintenance

One restraint a firm can use on its distributor, called resale price maintenance, is to specify to the latter at what amount the product is to be sold. As mentioned, one of the aspects of business format franchising is uniformity. To the customers, the entire brand is just one body. The goodwill of one is the goodwill of all. The business format that is the key to the success of the franchise is replicated as much as possible and takes advantage of the goodwill built by the system. Hence, most franchised businesses have set menus with already well defined prices. Customers walk in knowing exactly what they want to order and how much money they will have to pay. For most, it compels them to walk in a place they have technically never been to before. That, however, is a vertical restraint which must come under the scrutiny of antitrust principles.

Also, a recent trend in fast food franchises is the delivery hotline system. More and more of these companies are registering easy to remember phone numbers in the expectation that customers will have no difficulty contacting them should they want to purchase food from them. An even more recent development of this phenomenon is the online ordering system. The orders from both of these systems are forwarded to the nearest branch. For the franchisor to monitor the different prices of different branches would be a huge and costly logistical problem.

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158. *Leegin*, 551 U.S at 885-86 (citations omitted).

159. State Oil Co. v. Khan et al., 522 U.S. 3, 10 (1997) (U.S.).

160. Albrecht v. Herald Co., 390 U.S. 145, 159 (1968) (J. Harlan, dissenting opinion) (U.S.).

161. *Id.* at 165.

One of the first U.S. cases that dealt with resale price maintenance was *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[162] Dr. Miles Medical Co. was in the business of selling patented medicines.[163] It sold through a number of distributors using a couple of agreements named "Consignment Contract — Wholesale" and "Retail Agency Contract."[164] In the contracts, Dr. Miles Co. enumerated a list of the minimum prices that the "agents" should sell at. Additionally, they were only allowed to sell to accredited "retail agents."[165] John D. Park & Sons refused to sign the agreement but were able to procure from wholesalers products which it then sold to the public at lower prices.[166] The U.S. Supreme Court sidestepped the consignment versus sale issue by stating that once a wholesaler sold a product to another wholesaler, it was a sale. There was nothing in the allegations or the contract that said that sale to another wholesaler would maintain the consigned character of the goods.[167] Since it was not clear where the wholesaler sourced the goods John D. Park bought from them, then it could easily have not been consigned goods. The Court then moved to rule on the issue of Dr. Miles' restriction of the minimum price the distributors were allowed to sell at:

> Agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer.
>
> ...
>
> The complainant's plan falls within the principle which condemns contracts of this class. It, in effect, creates a combination for the prohibited purposes. No distinction can properly be made by reason of the particular character of the commodity in question. It is not entitled to special privilege or immunity. It is an article of commerce, and the rules concerning the freedom of trade must be held to apply to it. Nor does the fact that the margin of freedom is reduced by the control of production make the protection of what remains, in such a case, a negligible matter. And where commodities have passed into the channels of trade and are owned by dealers, the validity of agreements to prevent competition and to maintain prices is not to be determined by the circumstance whether they were produced by several manufacturers or by one, ... or whether they were previously owned by one or by many. The complainant having sold its

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162. Dr. Miles Medical Co. v. John D. Park and Sons Co., 220 U.S. 373 (1911) (U.S.).

163. *Id.* at 374.

164. *Id.* at 375-80.

165. *Id.* at 377.

166. *Id.* at 394.

167. *Id.* at 397-98.

> product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic.[168]

Thus, the U.S. Supreme Court declared minimum resale price maintenance *per se* illegal for being contrary to public interest and, in effect, void. It declared that there was no distinction or special circumstance under which an exception could be made. The crux of the argument of the Court here was based on property rights logic. The right to set the price upon which one's property is to be alienated is an incidence of ownership of the individual. Competition depends on the property holder's exercise of this right. Hence, agreements which limit this are regarded to be in restraint of trade.[169]

The next case that comes into the vertical restraint problem is *Albrecht v. Herald Co.*.[170] Herald Co. was the newspaper publisher of the Globe-Democrat.[171] Albrecht was among those who were allotted specific territories within which it is assigned distribution of the newspapers.[172] Herald Co. maintained a suggested retail price that the newspapers could be sold to the public.[173] Albrecht was contacted by Herald Co. and was told that he was overcharging in the sale of the newspapers.[174] Herald Co. hired Milne Circulation Sales Inc. to start soliciting the customers of Albrecht.[175] A third party, George Kroner, was engaged to take over the territory.[176] Albrecht was told by Herald Co. that he would be given his customers back if he discontinued his pricing practices.[177] This prompted a lawsuit for damages under the Sherman Antitrust Act by Albrecht. The Court ruled:

> Maximum and minimum price fixing may have different consequences in many situations. But schemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market. Competition, even in a single product, is not cast in a single mold. Maximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which

168. *Dr.Miles*, 220 U.S. at 408-09 (citations omitted).

169. *See* Rudolph J. Peritz, *A Genealogy of Vertical Restraints Doctrine*, 40 HASTINGS L.J. 511, 519-22 (1989).

170. Albrecht v. Herald Co., 390 U.S. 145, 159 (1968) (U.S.).

171. *Id.* at 147.

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Albrecht*, 390 U.S. at 147.

177. *Id.* at 147-48.

> they are willing to pay. Maximum price fixing may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice competition. Moreover, if the actual price charged under a maximum price scheme is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices. It is our view, therefore, that the combination formed by the respondent in this case to force petitioner to maintain a specified price for the resale of the newspapers which he had purchased from respondent constituted, without more, an illegal restraint of trade under [] the Sherman [Antitrust] Act.
>
> ...
>
> The assertion that illegal price fixing is justified because it blunts the pernicious consequences of another distribution practice is unpersuasive. If, as the Court of Appeals said, the economic impact of territorial exclusivity was such that the public could be protected only by otherwise illegal price fixing itself injurious to the public, the entire scheme must fall under 1 of the Sherman [Antitrust] Act.[178]

Albrecht followed suit to *Dr. Miles* and also held maximum resale price maintenance to be *per se* illegal. *Albrecht* follows the line of thinking that prompted the *Dr. Miles* decision. The majority's opinion provides that the best way to foster competition is to break up as many combinations as possible and disperse the rights holders as much as possible.[179] When faced with the argument that the maximum resale price was a system that worked together with the assignment of exclusive territories in order to avoid abuse of monopoly power, the Court thought that it would be better to get rid of the whole system altogether.

Justice Harlan made a persuasive dissent.[180] He starts by a reiteration of the minimum resale price maintenance justification for *per se* illegality. Then, he differentiates the case of maximum resale price maintenance. He argues that in minimum resale price maintenance, the danger comes in setting a floor price that keeps competing firms from reaching a competitive price which might be lower. Such a case would be detrimental to the welfare of consumers and is abhorred by the State. On the other hand, maximum retail price maintenance can lower price to a level that it would have taken in the existence of intense competition. This is especially useful to industries such as newspaper publication whose distributorship needs to be and is in practice in contiguous zones.[181] This necessitates the use of the maximum resale price

178. *Id.* at 152-54.

179. Peritz, *supra* note 169.

180. *Albrecht*, 390 U.S. 145, 156 (J. Harlan, dissenting opinion).

181. *Id.* at 166.

maintenance and territorial restriction system in order to avoid cartels and abuse of monopoly power.[182]

Ironically, *Albrecht* faced a situation that actually provided a scenario that illustrated a pro-competitive justification for maximum resale price maintenance. As Justice Harlan observed, rather than addressing the issue, all the *Albrecht* decision did was to enumerate all of their fears as to what could happen.[183]

Albrecht would eventually be overturned three decades later with *State Oil v. Khan.*[184] Barkat Khan leased the operation of a gasoline station from State Oil.[185] State Oil required a minimum and maximum resale price from Khan.[186] If Khan went lower than the minimum, he loses his profit margin.[187] If he went higher than the maximum, the excess is rebated to State Oil.[188] Khan failed to meet rentals and the station was put under receivership.[189] The receiver, however, was not put under the same resale price requirements.[190] Khan filed a case for violation of the Sherman Antitrust Act. The Court ruled that:

> As for maximum resale price fixing, unless the supplier is a monopsonist he cannot squeeze his dealers' margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier. A supplier might, however, fix a maximum resale price in order to prevent his dealers from exploiting a monopoly position. ... [S]uppose that State Oil, perhaps to encourage ... dealer services ... has spaced its dealers sufficiently far apart to limit competition among them (or even given each of them an exclusive territory); and suppose further that Union 76 is a sufficiently distinctive and popular brand to give the dealers in it at least a modicum of monopoly power. Then State Oil might want to place a ceiling on the dealers' resale prices in order to prevent them from exploiting that monopoly power fully. It would do this not out of disinterested malice, but in its commercial self-interest. The higher the price at which gasoline is resold, the smaller the volume sold, and so the

182. *Id.*

183. *See generally Albrecht*, 390 U.S. 145.

184. State Oil Co. v. Khan et al., 522 U.S. 3, 10 (1997) (U.S.).

185. *Id.* at 7-8.

186. *Id.* at 8.

187. *Id.*

188. *Id.*

189. *Id.*

190. *State Oil*, 522 U.S. at 8.

> lower the profit to the supplier if the higher profit per gallon at the higher price is being snared by the dealer.[191]

It further stated that whatever fears *Albrecht* had, it could easily be allayed by the rule of reason standard. This decision marked the partial return of price restraints into the standard of the rule of reason, following similar rulings on non-price restraints in *Continental TV, Inc. v. GTE Sylvania Inc.*[192]

Finally, the U.S. Supreme Court resolved to turn over the 96-year doctrine of *Dr. Miles* in *Leegin Creative Leather Products Inc., v. PSKS.*[193] Leegin Inc., sold belts and other leather products under the brand name, "Brighton."[194] It took notice of the fact that smaller retailers often provided better customer service than large discount outlets.[195] Leegin Inc.'s corporate policy was to build up the brand by marketing it under a "specialty store" where "quality merchandise," "superb service," and "support" can be given.[196] Hence, it undertook to provide minimum resale prices to its distributors.[197] It also launched the "Heart Store" marketing program.[198] The defendant, Kay's Kloset, has been a long time distributor.[199] Although they initially followed the system, even becoming a Heart Store, subsequent inspections showed decline in the quality which resulted in, first, removal of their Heart Store designation and, later, their removal as a distributor.[200] What set off the latter was the discovery by Leegin Inc. that Kay's Kloset had marked down the "Brighton" products by as much as 20%.[201] As response to their removal, Kay's Kloset filed an action for violation of Section 1 of the Sherman Antitrust Act. Instead of trying to disprove the existence of a minimum resale price maintenance scheme, Leegin opted to admit it and build its defense on the pro[-]competitive effects of the system and prayed for the application of the rule of reason.[202] The Court ruled, as mentioned above, to wit:

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191. *Id.* at 15-16 (citing State Oil v. Khan, 93 F.3d 1358, 1362 (7th Cir. 1996) (U.S.)).

192. Continental TV v. GTE Sylvania, 433 U.S. 36 (1977) (U.S.).

193. Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (U.S.).

194. *Id.* at 882.

195. *Id.*

196. *Id.* at 883.

197. *Id.*

198. *Id.* at 882-84.

199. *Leegin,* 551 U.S. at 884.

200. *Id.*

201. *Id.*

202. *See Leegin,* 551 U.S. at 884.

> '[T]he state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today.'
>
> ...
>
> Minimum resale price maintenance can stimulate interbrand competition — the competition among manufacturers selling different brands of the same type of product — by reducing intrabrand competition — the competition among retailers selling the same brand. ... The promotion of interbrand competition is important because 'the primary purpose of the antitrust laws is to protect [this type of] competition.' ... A single manufacturer's use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers. Resale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.
>
> ...
>
> The Court has thus explained that administrative 'advantages are not sufficient in themselves to justify the creation of *per se* rules.'
>
> ...
>
> We think that were the Court considering the issue as an original matter, the rule of reason, not a *per se* rule of unlawfulness, would be the appropriate standard to judge vertical price restraints. [Dr. Miles] is a flawed antitrust doctrine that serves the interests of lawyers — by creating legal distinctions that operate as traps for the unwary — more than the interests of consumers — by requiring manufacturers to choose second-best options to achieve sound business objectives.[203]

Leegin had a number of effects. First, it rendered the necessity of making Dr. Miles-Colgate restrictions moot. A few years after *Dr. Miles* was promulgated, the U.S. Supreme Court, in an effort to mitigate the effects of the *per se* rule they had just implemented, promulgated *United States v. Colgate & Co.*.[204] *Colgate* basically stated that the *per se* rule of *Dr. Miles* only applied to "agreements" in restraint of trade.[205] Therefore, the logical conclusion is that if there is no such agreement, such as when it can be shown that it was merely a unilateral action on the part of the franchisor, then there is no violation of the Sherman Antitrust Act. This induced a number of practices that tried to implement *Colgate* that resulted in a

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203. *Leegin*, 551 U.S. at 888-99 (citations omitted).

204. United States v. Colgate & Co., 250 U.S. 300 (1919) (U.S.).

205. *Id.* at 306-07.

plethora of cases that dropped ambiguous guidelines. *Leegin* makes this point moot, making it much simpler for franchisors to implement their systems.[206]

Additionally, it also made franchising more attractive as a vertical distribution method compared to other methods such as vertical integration.

Resale price maintenance came in full circle with the *Leegin* ruling. It was not a ruling that just came out of the blue. It had been coming for a long, long time. It was preceded by a series of rulings in the U.S. Supreme Court of reevaluating the doctrines they had promulgated in the early days that, at the time, led them to call for *per se* rules. As more and more information about the pro-competitive effects of vertical restraints, the Supreme Court has been chipping away from the hard and fast *per se* rule.

3. Tying Agreements

A tying agreement is "an agreement by a party to sell one product, but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[207] The danger that this presents comes from the fact that a person who has market power in one product may use tying as a measure of extending such market power into the other. Hence, that person can obtain market power in the tied product market even if it is not the most competitive.

Franchisors use tying agreements in compelling purchases of certain materials or ingredients from them by making it a condition for the purchase of the franchise, which is a patentable system and, therefore, a good that can be the subject of tying. This usually aids franchisors in keeping their trade secrets confidential, specifically by producing the parts of the product that contains the trade secret themselves such as, for example, the secret sauce in a restaurant. Through this, it can retain for itself some of the valuable trade secrets of the business format.

Tying agreements also allow the franchisor to maintain the image of the business. In case there are some specifications in the design which the franchisee is unable to comply with at a competitive price, the franchisor having had replicated the business a number of times might be the best person to offer it.

One of the earlier cases involving tying and antitrust is *International Salt Co. v. United States*.[208] International Salt was in the business of selling salt.[209]

206. *See* Comment, *Minimum Resale Price Maintenance*, 121 HARV. L. REV. 425, 434 (2007).

207. Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5-6 (1958) (U.S.).

208. International Salt Co. v. United States, 332 U.S. 392 (1947) (U.S.).

209. *Id.* at 394.

Additionally, it had the patents to two machines that performed industrial application to salt, namely "Saltomat" and "Lixator."[210] International Salt conditioned the lease of the two machines to the purchase of their salt by the lessees.[211] The Court found this to be an antitrust violation. It had this to say about the concept of tying agreements:

> Appellant contends, however, that summary judgment was unauthorized because it precluded trial of alleged issues of fact as to whether the restraint was unreasonable within the Sherman [Antitrust] Act or substantially lessened competition or tended to create a monopoly in salt within the Clayton [Antitrust] Act. We think the admitted facts left no genuine issue. Not only is price-fixing unreasonable, *per se*, ... but also it is unreasonable *per se* to foreclose competitors from any substantial market. ... The volume of business affected by these contracts cannot be said to be insignificant or insubstantial, and the tendency of the arrangement to accomplishment of monopoly seems obvious. Under the law, agreements are forbidden which 'tend to create a monopoly,' and it is immaterial that the tendency is a creeping one, rather than one that proceeds at full gallop; nor does the law await arrival at the goal before condemning the direction of the movement.[212]

The Court was responding to an argument by the plaintiff that they should at least be subject to the rule of reason and not be put under summary judgment based on a *per se* illegal consideration.[213] The Court rejected this notion and instituted a *per se* regime on tying agreements. As for the other issues tackled, the Court struck down a clause providing that the buyer can still buy salt from other companies unless International Salt can match its price as this forces the competitor to price cut.[214] It also held that plaintiff's contention that the reason for the tie is that International Salt produces the high grade salt needed by the machines.[215] The Court was of the view that this could have been handled by specification.[216]

In 1958, the Court came out with *Northern Pacific Railway Co. v. United States*.[217] Northern Pacific was a railroad company that had vast pieces of land.[218] In selling its land parcels, it made a condition that everything produced in the land will be shipped using Northern Railway as long as its

210. *Id.*

211. *Id.*

212. *Id.* at 396 (citations omitted).

213. *Id.*

214. *International Salt*, 332 U.S. at 397-98.

215. *Id.*

216. *Id.* at 400-02.

217. Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958) (U.S.).

218. *Id.* at 4.

rate was equal to the other carriers.[219] The Court found the company to have violated the Sherman Antitrust Act:

> Indeed, 'tying agreements serve hardly any purpose beyond the suppression of competition.' ... They deny competitors free access to the market for the tied product not because the party imposing the tying requirements has a better product or a lower price, but because of his power or leverage in another market. At the same time, buyers are forced to forego their free choice between competing products. For these reasons, 'tying agreements fare harshly under the laws forbidding restraints of trade.' ... They are unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a 'not insubstantial' amount of interstate commerce is affected.[220]

After numerous case law applying the *per se* rule, *Jefferson Parish Hospital District No. 2 v. Hyde*[221] solidified the test to be applied for *per se* illegality and its requisites. It put forth the three requisites in order for there to be a *per se* illegal treatment of the tying agreement. First, there must be an arrangement between two separate products, the tying and the tied product.[222] Second, the seller has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product.[223] Third, a "not insubstantial" amount of interstate commerce is affected.[224] This has become known as the conditional *per se* test.[225]

Susser et al. v. Carvel Corp. et al.[226] adds another requisite that is used for application of the *per se* illegality to franchising agreements. The case involved the franchise system of the Carvel Corporation which was in the business of franchising a restaurant business. The Court recognized the value of trademark and goodwill to a franchised business. The Court added that for an unlawful tying agreement to exist, a fourth requisite, namely that there be no justification for the tying arrangement, should be present. This is known as the modified *per se* test.[227]

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219. *Id.*

220. *Id.* at 6 (citations omitted).

221. Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984) (U.S.).

222. *Id.* at 19-20.

223. *Id.* at 28-29.

224. *Id.* 29-30.

225. *Id.* at 33-35. *See also Northern Pacific*, 356 U.S. at 5-6 & Frank A. Camp, *Big Mac Attacks The Chicken Delight Rule*, 7 J. CORP. L 137, 139 (1981).

226. Susser et al. v. Carvel Corp. et al., 332 F.2d 505 (2d Cir 1964) (U.S.).

227. *Id. See also* Camp, *supra* note 225, at 139.

Regarding the first requirement of having separate products, the leading cases for the franchising industry are still *Siegel v. Chicken Delight*[228] and *Principe v. McDonald's*.[229] In *Siegel*, the Court held that a trademark could be a separable product that could be the basis of a tie-in.[230] It stated:

> The relevant question is not whether the items are essential to the franchise, but whether it is essential to the franchise that the items be purchased from Chicken Delight. This raises not the issue of whether there is a tie-in but rather the issue of whether the tie-in is justifiable.[231]

Principe provided for a different test. The Court pointed out that franchising is more than just the trademark.[232] It is a complete method of doing business which encompassed all aspects of the business which should be regarded as just one product along with it, to wit:

> Given the realities of modern franchising, we think the proper inquiry is not whether the allegedly tied products are associated in the public mind with the franchisor's trademark, but whether they are integral components of the business method being franchised. Where the challenged aggregation is an essential ingredient of the franchised system's formula for success, there is but a single product and no tie in exists as a matter of law.[233]

Regarding the second requirement of having sufficient economic power, U.S. jurisprudence has gone through some different changes. In *United States v. Lowe's Inc.*,[234] the Court stated that a patent can give rise to a presumption of market power.[235] Additionally, market power can be inferred from the desirability of the product and its unique attributes.[236] This was recently overturned in *Illinois Tool Works v. Independent Ink, Inc.*[237] where the Court took away the presumption in recognition that it did not necessarily reflect economic theory.[238]

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228. Siegel v. Chicken Delight Inc., 448 F.2d 43 (9th Cir 1971) (U.S.).

229. Principe v. McDonald's Corporation, 631 F.2d 303 (4th Cir 1980) (U.S.).

230. *Siegel*, 448 F.2d at 47.

231. *Id.* at 49.

232. *Principe*, 631 F.2d 303.

233. *Id.*

234. United States v. Lowe's Incorporated, 371 U.S. 38 (1968) (U.S.).

235. *Id.* at 48.

236. J. Thomas McCarthy, *Trademark Franchising and Antitrust: The Trouble with Tie-Ins*, 58 CAL. L. REV 1056 (1970).

237. Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006) (U.S.).

238. *Id.* at 44-46.

Regarding the third requisite of having affected a not insubstantial amount of trade, the Court in *Fortner Enterprises v. United States Steel Corp.*,[239] held:

> The requirement that a 'not insubstantial' amount of commerce be involved makes no reference to the scope of any particular market or to the share of that market foreclosed by the tie, and hence we could not approve of the trial judge's conclusions on this issue even if we agreed that his definition of the relevant market was the proper one. An analysis of market shares might become relevant if it were alleged that an apparently small dollar volume of business actually represented a substantial part of the sales for which competitors were bidding. But normally the controlling consideration is simply whether a total amount of business, substantial enough in terms of dollar volume so as not to be merely de minimis, is foreclosed to competitors by the tie, for, as we said in *International Salt*, it is 'unreasonable *per se* to foreclose competitors from any substantial market' by a tying arrangement[.][240]

Tying agreements are still within the realm of the *per se* doctrine, albeit modified. The Court has on more than one occasion voiced out the error of earlier decisions denouncing any usefulness of tying agreements. However, the Court was still hesitant to return to the rule of reason standard. One curious thing worthy of mentioning with respect to the tying doctrine is that it seems to have taken on a life of its own. For an arrangement which the Supreme Court seems to be very hesitant to move into the rule of reason classification, the test seems to be getting more and more complicated to the point where it is practically at the level of analysis comparable to a rule of reason consideration. The ratio of a *per se* rule is efficiency, that is, a full blown trial is substituted for a summary judgment because the Court feels that a discussion of the obvious is futile. Yet, tying, for a supposedly obvious decision, has numerous cases and ambulatory jurisprudence on not just the test to be applied but on the respective tests to be applied on the elements of the main test.

4. Exclusive Dealing

Exclusive Dealing is the practice of requiring one's buyer to not use the product of a competitor.[241] Compared to the other vertical restrictions, litigation on exclusive dealing has been few. One of the most recent cases is *Tampa Electric Co. v. Nashville Coal Co.*,[242] a case that is already 50 years old.

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239. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969) (U.S.).

240. *Id.* at 501.

241. AREEDA & KAPLOW, *supra* note 112, at 772.

242. Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961) (U.S.).

The Court enumerated what was needed for there to be an antitrust violation:

> First, the line of commerce ... involved must be determined[.] ... Second, the area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practicably turn for supplies[.] ... Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market.
>
> To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is of little consequence.[243]

Exclusive Dealing can easily be justified by just showing that a substantial amount of the market is foreclosed, which rarely happens for most businesses. Unfortunately, the few district court cases that have been decided on Exclusive Dealing have yet to leave a consistent standard as to what that is. *Jefferson Parish*, though, has ruled that 30% was substantial.[244]

5. Territorial Restrictions and other Non-Price Restraints

Of course vertical restraints are not limited to manipulation of prices. It can also take on other forms. The first case to have made the distinction between price and non-price restraints was *White Motor Co. v. United States*.[245] White Motor was in the business of making trucks.[246] It sold them through distributors.[247] It was charged with an antitrust violation for imposing, among others, territorial restrictions, that is, the dealers were only allowed to sell in a specified geographic area.[248] The Court held:

> Horizontal territorial limitations, like '[g]roup boycotts, or concerted refusals by traders to deal with other traders[,]' ... are naked restraints of trade with no purpose except stifling of competition. A vertical territorial limitation may or may not have that purpose or effect. We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. They may be too dangerous to sanction, or they may

243. AREEDA & KAPLOW, *supra* note 112, at 784 (citing *Tampa Electric*, 365 U.S. at 327-29).

244. *Jefferson*, 466 U.S. at 7.

245. White Motor Co. v. United States, 372 U.S. 253 (1963) (U.S.).

246. *Id.* at 255.

247. *Id.*

248. *Id.* at 255-56.

> be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business ... and within the 'rule of reason.' We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack ... any redeeming virtue' ... , and therefore should be classified as *per se* violations of the Sherman [Antitrust] Act.[249]

Being a case of first impression, the Court held back from declaring a *per se* rule and deemed it wise that a full blown trial be undertaken until such a time when they can learn about its effects.

The next significant case would be *United States v. Arnold, Schwinn and Co.*[250] Schwinn was a bicycle manufacturer who sold their products to distributors either on consignment or on sale.[251] They also imposed territorial restrictions upon the distributors.[252] The Court held the practice of territorial restrictions in a consignment contract as being under the rule of reason.[253] It echoed *White Motor* and ruled that vertical territorial limitations are different from horizontal ones and should be treated differently.[254] However, it declared *per se* illegal the territorial restrictions that accompanied the sales.[255] The ratio used was a throwback to the *Dr. Miles* property logic which stated that once ownership of the product has left the seller, he has no business making agreements with the buyer regarding the good.[256]

Arnold would soon be overturned by *Continental*.[257] Defendant Sylvania was a manufacturer of television sets.[258] Just like Arnold, it sought to limit the retailers they had in an area and imposed conditions on the retailers not to sell outside their area.[259] This prompted a disgruntled retailer to file an antitrust case against Sylvania.[260] Since the television sets were sold and not consigned, an application of the *per se* doctrine in *Arnold* was called for.[261] The Court held:

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249. *Id.* at 263.

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

251. *Id.* at 368.

252. *Id.* at 371.

253. *Id.* at 380-81.

254. *Id.* at 372.

255. *Id.* at 380-381.

256. *Compare Arnold*, 388 U.S. at 379-80 *with Dr. Miles*, 220 U.S. at 404-05.

257. *Continental*, 433 U.S. 36.

258. *Id.* at 38.

259. *Id.*

260. *Id.* at 39.

261. *See Continental*, 433 U.S. at 40-43.

> Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers. Location restrictions have this effect because of practical constraints on the effective marketing area of retail outlets. Although intrabrand competition may be reduced, the ability of retailers to exploit the resulting market may be limited both by the ability of consumers to travel to other franchised locations and, perhaps more importantly, to purchase the competing products of other manufacturers. None of these key variables, however, is affected by the form of the transaction by which a manufacturer conveys his products to the retailers.
>
> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These 'redeeming virtues' are implicit in every decision sustaining vertical restrictions under the rule of reason.[262]

Also,

> [T]he distinction drawn in [*Arnold*] between sale and nonsale transactions is not sufficient to justify the application of a *per se* rule in one situation and a rule of reason in the other. The question remains whether the *per se* rule stated in [*Arnold*] should be expanded to include nonsale transactions or abandoned in favor of a return to the rule of reason. We have found no persuasive support for expanding the *per se* rule.[263]

Continental was a landmark case not only because it classified non-price vertical restrictions under the rule of reason but it also served as the reference for subsequent decisions such as *State Oil* and *Leegin* to rule that there is enough pro-competitive justification in vertical restraint to exclude it from a *per se* illegal classification.

One of the first things one can see from the development of the case law on vertical restraints is the direction of the U.S. towards the rule of reason. Over time, it was less and less willing to stamp the *per se* illegality brand on vertical restraints. The short lived *per se* ruling on *Arnold* was overturned by *Continental*. The *per se* ruling on maximum resale price maintenance was overturned by *State Oil*. Finally, even the 96-year *per se* ruling on minimum resale price maintenance was overturned by *Leegin* effectively making reasonable price fixing lawful. It bears repeating that *per se* rules should only be used when one is so certain of the manifest and damaging effect of the restraint on competition. The U.S. Supreme Court's act of systematically reeling back from the *per se* rules is the uncertainty that was created by the influx of pro-competitive theories during the 70s. The reason is not necessarily because the Court had determined that the pro-competitive theories had overwhelmed the anti-competitive ones. It is because it was at the very least sufficient to cast enough uncertainty to warrant an inquiry

262. *Continental*, 433 U.S. at 54.

263. *Id.* at 57.

under the rule of reason. The usual standard for antitrust violations, as stated in *Standard Oil*,[264] is the rule of reason. The Intellectual Property Code, which became effective two months after the promulgation of the *State Oil* doctrine, unfortunately still retains the *per se* doctrine of resale price maintenance.

C. European Union Regulation

As mentioned, vertical restrictions in the European Union (E.U.) comes under the coverage of Article 85 of the Treaty Establishing the European Community.[265] Article 85 (1) provides a prohibition on agreements which prevents, restricts, or distorts competition and then enumerates some agreements that are considered to do just that.[266] Article 85 (2) declares any such agreement that violates the prohibition to be void.[267] However, Article 85 (3) provides for exemption from the application of Article 85 (1).[268] Unlike in the U.S., which makes use of the rule of reason to evaluate each case according to the merits of its anti-competitive and pro-competitive effects, the system employed by the E.U. is to apply the prohibition to as wide a coverage as possible and then subsequently provide block exemptions to take certain agreements out of the application.

1. Pronuptia de Paris GMBH v. Pronuptia de Paris Irmgard Schillgallis

The first case that dealt with the issue of vertical restraints in business format franchising agreements in the E.U. was *Pronuptia de Paris GMBH v. Pronuptia de Paris Irmgard Schillgallis*.[269] Pronuptia de Paris GMBH was in the business of selling wedding dresses as well as other clothing used in weddings under the name "Pronuptia de Paris."[270] It entered into a franchising agreement with Mrs. Irmgard Schillgallis for the latter to operate a branch that would sell the former's products.[271] Litigation ensued where the applicability of Article 85 to business format franchising agreements was put in issue. The European Court of Justice made the following rulings:

> Franchise agreements for the distribution of goods differ in that regard from dealerships or contracts which incorporate approved retailers into a selective distribution system, which do not involve the use of a single

264. *See generally Standard Oil*, 221 U.S. 1.

265. TEEC, *supra* note 122, art. 85.

266. *Id.*

267. *Id.*

268. *Id.*

269. Case 161/84, Pronuptia de Paris GMBH v. Pronuptia de Paris Irmgard Schillgallis, 1986 E.C.R. 353 (E.U.).

270. *Id.*

271. *Id.*

business name, the application of uniform business methods or the payment of royalties in return for the benefits granted. Such a system, which allows the franchisor to profit from his success, does not in itself interfere with competition. In order for the system to work two conditions must be met.

First, the franchisor must be able to communicate his know-how to the franchisees and provide them with the necessary assistance in order to enable them to apply his methods, without running the risk that that know-how and assistance might benefit competitors, even indirectly. It follows that provisions which are essential in order to avoid that risk do not constitute restrictions on competition for the purposes of Article 85 (1).

...

Secondly, the franchisor must be able to take the measures necessary for maintaining the identity and reputation of the network bearing his business name or symbol. It follows that provisions which establish the means of control necessary for that purpose do not constitute restrictions on competition for the purposes of Article 85 (1).

...

It may in certain cases — for instance, the distribution of fashion articles — be impractical to lay down objective quality specifications. Because of the large number of franchisees it may also be too expensive to ensure that such specifications are observed. In such circumstances a provision requiring the franchisee to sell only products supplied by the franchisor or by suppliers selected by him may be considered necessary for the protection of the network's reputation. Such a provision may not however have the effect of preventing the franchisee from obtaining those products from other franchisees.

...

It must be emphasized on the other hand that, far from being necessary for the protection of the know-how provided or the maintenance of the network's identity and reputation, certain provisions restrict competition between the members of the network.

...

The attention of the national court should be drawn to the provision which obliges the franchisee to sell goods covered by the contract only in the premises specified therein. That provision prohibits the franchisee from opening a second shop. Its real effect becomes clear if it is examined in conjunction with the franchisor's undertaking to ensure that the franchisee has the exclusive use of his business name or symbol in a given territory. In order to comply with that undertaking the franchisor must not only refrain from establishing himself within that territory but also require other franchisees to give an undertaking not to open a second shop outside their own territory. A combination of provisions of that kind results in a sharing of markets between the franchisor and the franchisees or between franchisees and thus restricts competition within the network. As is clear from the judgment of 13 July 1966 ... , a restriction of that kind constitutes a limitation of competition for the purposes of Article 85 (1) if it concerns a

> business name or symbol which is already well-known. It is of course possible that a prospective franchisee would not take the risk of becoming part of the chain, investing his own money, paying a relatively high entry fee and undertaking to pay a substantial annual royalty, unless he could hope, thanks to a degree of protection against competition on the part of the franchisor and other franchisees, that his business would be profitable. That consideration, however, is relevant only to an examination of the agreement in the light of the conditions laid down in Article 85 (3).
>
> ...
>
> Although provisions which impair the franchisee's freedom to determine his own prices are restrictive of competition, that is not the case where the franchisor simply provides franchisees with price guidelines, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices. It is for the national court to determine whether that is indeed the case. [272]

One important implication of *Pronuptia* is the express recognition of the European Court of Justice of the uses of vertical restraints, especially in franchising agreements where it can even be essential or necessary to the implementation of the agreement so much so that it cannot be held to be restrictions on competition. It even espouses two well-known pro-competitive theories of vertical restraints, namely, avoiding free riding and quality control.

The decision also gives one very good example for tying and exclusive dealing agreements — the fashion industry. In such a case, what can be considered fashionable and current is very hard to translate into objective specifications. This is a very good argument against the anti-competitive theorists which usually state that mere specification should be sufficient.

However, *Pronuptia* also illustrates the hard line that the E.U. has drawn regarding certain vertical restraints. For example, it regards the practice of restricting franchisees to certain defined territories as restrictions on competition. In comparison, territorial and other non-price restraints were one of the first practices to be held to have pro-competitive effects by the U.S. Supreme Court in *Continental*.[273] There is also a strong sentiment against retail price maintenance. The decision suggests the use of suggested retail prices.

2. Commission Regulation 4087/88

A mere three years after *Pronuptia*, the European Commission came out with the Commission Regulation No. 4087/88 of 30 November 1988 on the Application of Article 85 (3) of the Treaty Establishing the European

272. *Id.* at 381-84.

273. *See Continental*, 433 U.S. 36.

Community to Categories of Franchise Agreements. The regulation starts out with the recognition of the uses of franchising agreements as started by *Pronuptia*:

> (1) Franchise agreements as defined in this Regulation normally improve the distribution of goods and/or the provision of services as they give franchisors the possibility of establishing a uniform network with limited investments, which may assist the entry of new competitors on the market, particularly in the case of small and medium-sized undertakings, thus increasing interbrand competition. They also allow independent traders to set up outlets more rapidly and with higher chance of success than if they had to do so without the franchisor's experience and assistance. They have therefore the possibility of competing more efficiently with large distribution undertakings.
>
> (2) As a rule, franchise agreements also allow consumers and other end users a fair share of the resulting benefit, as they combine the advantage of a uniform network with the existence of traders personally interested in the efficient operation of their business. The homogeneity of the network and the constant cooperation between the franchisor and the franchisees ensures a constant quality of the products and services. The favourable effect of franchising on interbrand competition and the fact that consumers are free to deal with any franchisee in the network guarantees that a reasonable part of the resulting benefits will be passed on to the consumers.[274]

In the Regulation, the Commission retained the hard line rule against resale price maintenance or when "the franchisee is restricted by the franchisor, directly or indirectly, in the determination of sale prices for the goods or services which are the subject-matter of the franchise, without prejudice to the possibility for the franchisor of recommending sale prices."[275] The Regulation also prohibits practices where "the franchisee is prevented from obtaining supplies of goods of a quality equivalent to those offered by the franchisor."[276]

However, probably as an effect of the facts in *Pronuptia*, there are two exemptions to the rule. First is if the method of specification is impractical, owing to the nature of the subject matter.[277] Second is in the case of an obligation not to use goods of those competing with the franchisor's that is the subject matter of the franchise.[278] Furthermore, in exclusive dealing

274. Commission Regulation 4087/88, whereas cl.

275. *Id.* art. 5 (e).

276. *Id.* art. 5 (b).

277. *Id.* art. 3 (1) (b).

278. *Id.* art. 2 (e).

arrangements where the franchisor makes it mandatory that supplies be obtained through him or a specified third party, the regulation provides that "protecting the franchisor's industrial or intellectual property rights"[279] otherwise known as trade secrets, and "maintaining the common identity and reputation of the franchised network"[280] otherwise known as quality control, as well as impracticability of specifications are justifiable reasons. The first two justifications can also be seen as an effect of the *Pronuptia*.

One aspect where *Pronuptia* did not seem to be controlling is the use of territorial restraints. The regulation exempts from the application of Article 81 (1):

> (a) an obligation on the franchisor, in a defined area of the common market, the contract territory, not to:
>
> — grant the right to exploit all or part of the franchise to third parties,
>
> — itself exploit the franchise, or itself market the goods or services which are the subject-matter of the franchise under a similar formula, and
>
> — itself supply the franchisor's goods to third parties;
>
> (b) an obligation on the master franchisee not to conclude franchise agreement with third parties outside its contract territory;
>
> (c) an obligation on the franchisee to exploit the franchise only from the contract premises;
>
> (d) an obligation on the franchisee to refrain, outside the contract territory, from seeking customers for the goods or the services which are the subject-matter of the franchise.[281]

3. The Green Paper

Regulation 4087/88 expired in 1999.[282] As it was about to expire, there were sentiments to effect a unified block exemption to all kinds of vertical restraints. Studies were done and the Commission came out with the Green Paper on Vertical Restraints in EC Competition Policy[283] as a means of determining how future regulation should be undertaken. It starts out, again, with a recognition of the uses of vertical restraints:

> Vertical restraints are no longer regarded as *per se* suspicious or *per se* pro-competitive. Economists are less willing to make sweeping statements.

279. *Id.*

280. Commission Regulation 4087/88, art. 2 (e).

281. *Id.* art 2.

282. *Id.*

283. *Commission Green Paper on Vertical Restraints in EC Competition Policy*, COM (1996) 721 final (Jan. 2, 1997).

> Rather, they rely more on the analysis of the facts of a case in question. However, one element stands out: the importance of market structure in determining the impact of vertical restraints. The fiercer is interbrand competition, the more likely are the pro-competitive and efficiency effects to outweigh any anti-competitive effects of vertical restraints. Anti-competitive effects are only likely where interbrand competition is weak and there are barriers to entry at either producer or distributor level. In addition it is recognised that contracts in the distribution chain reduce transaction costs, and can allow the potential efficiencies in distribution to be realised. In contrast, there are cases where vertical restraints raise barriers to entry or further dampen horizontal competition in oligopolistic markets.
>
> ...
>
> Other conclusions that can be drawn from recent economic analysis are that:
>
> — Individual clauses in an agreement or different types of vertical restraints cannot be considered *per se* as having a negative or positive effect on competition or integration.
>
> — The combination of several vertical restraints does not necessarily increase the probability of any anti-competitive outcome but in some circumstances may make the outcome more favourable.
>
> — Analysis should concentrate on the impact on the market rather than the form of the agreement. For example, whether entry is foreclosed by a network of agreements or whether the vertical agreement coupled with market power permit producers or distributors to practice price discrimination between different Member States.
>
> — Given the risk associated with either entry into new markets or significant market expansion (i.e. creation of new trade flows that integrate the market), consideration should be given to a more favourable treatment of vertical restraints where this is accompanied by significant material or immaterial investment. This more favourable treatment should be limited in time.
>
> — The nature of the products, the need for services and for investment to undertake efficient distribution and the needs and knowledge of consumers may all be important elements in determining both the objective efficiencies promoted by vertical restraints and any anticompetitive effects.[284]

The Green Paper made a summary of the competition policies of the E.U. at the time. True to the declaration given above that analysis should be done by looking at the market structure, de minimis or restraints that have no appreciable impact are excluded from the application of Article 85 (1). Above that, there are certain restraints that the E.U. will not tolerate such as resale price maintenance and territorial restrictions. The rest are analyzed on

284. *Id.* at exec. summary iii–iv.

a case-by-case analysis.[285] The Paper also took notice of the increasing sentiment that the method of the E.U. is not flexible enough.[286] The focus of the Green Paper was to look at distribution trends and realities in the E.U. It took notice of certain trends in information technology such as Just In Time (JIT), Quick Response Logistics (QR), and Effective Consumer Response (ECR) systems. The trend then is a movement from arms-length bargaining (which the anti-competitive theorists are so fond of) toward a more cooperative environment.

4. Commission Regulation 2790/1999

Pursuant to the Green Paper, Commission Regulation (EC) No. 2790/1999[287] was issued to replace 4087/88 and provide guidelines on the application of the exemption in Article 85 to vertical restraints. It starts off with the yet another recognition that

> (6) Vertical agreements of the category defined in this Regulation can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings; in particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimization of their sales and investment levels.
>
> (7) The likelihood that such efficiency-enhancing effects will outweigh any anti-competitive effects due to restrictions contained in vertical agreements depends on the degree of market power of the undertakings concerned and, therefore, on the extent to which those undertakings face competition from other suppliers of goods or services regarded by the buyer as interchangeable or substitutable for one another, by reason of the products' characteristics, their prices and their intended use.[288]

The reasoning in the Regulation, as well as those that came before it, is, curiously enough, in tune with the reasoning that gave rise to the reversion of non-price restraints, and resale price maintenance back into the rule of reason.

Despite this pronouncement, however, the exemption provided its own exemptions from its application. Minimum resale price maintenance was still explicitly declared to be prohibited in the Regulation[289] as well as it is in Article 85 (1) of the Treaty Establishing the European Community.[290] They

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285. *Id.* at exec. summary v–vi.

286. *Id.* at exec. summary ix–x.

287. Commission Regulation 2790/1999, 1999 O.J. (L 336) 21 (EC).

288. *Id.* whereas cl.

289. *Id.* art. 4 (a).

290. TEEC, *supra* note 122, art 85 (1).

may now, however, impose maximum resale price maintenance, make recommendations, or give a suggested retail price so long as there is no pressure imposed upon the franchisee or distributor to follow it.[291] While no direct relation to the U.S. antitrust case law can be seen, it is worth mentioning that this new Regulation, never before having been recognized, came at the heels of *State Oil* which put maximum resale price maintenance into the rule of reason regime. *Leegin*, which did the same for minimum resale price maintenance, would not be promulgated yet for another seven years. The Regulation [ ] expired in 2010.[292]

Exclusive dealing is allowed, provided it does not affect the market by more than the 30% ceiling.[293] Territorial Restrictions are generally still not allowed subject to a few exceptions.[294] Lastly, the exemption only applies if the agreement will not affect more than 30% of the market.[295]

While the E.U.'s Block Exemption may be more efficient than the rule of reason of the U.S., the latter gives much for flexibility in allowing agreements that serve a reasonable purpose. The weakness of the E.U.'s method can be seen on the presumption of illegality that lies until declared by the Regulation to be legal. As seen in *Albrecht*, there are some situations where a vertical restraint can be used in conjunction with another vertical restraint, such as a maximum retail price and territorial restriction combination, in order to avoid abuse of monopoly power in an industry susceptible to cartels.[296] While, unfortunately, the U.S. Supreme Court chose not to incorporate the merits of the scheme in *Albrecht*, the Court still had that option. In E.U.'s Block Exemption, this would have been impossible. That would probably explain the extraordinary care that the U.S. Supreme Court applies in handing out *per se* rules.

V. CONCLUSION

This Article sought to discover whether Business Format Franchise Agreements, an agreement that creates uniquely intimate vertical relationships, can require vertical restrictions in light of antitrust policies. In this manner, it can shed light on the field of antitrust jurisprudence particularly that of vertical restraints. The question can be answered by addressing the following queries:

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291. Commission Regulation 2790/1999, art. 4 (a).

292. *Id.* art. 13.

293. *Id.* art. 3 (2).

294. *Id.* art. 4 (b).

295. *Id.* art. 3, § 1.

296. *See Albrecht*, 390 U.S. 145.

(1) Whether or not franchisors can require their franchisees to follow:

(a) a minimum resale price

Recent jurisprudence has shown that resale price maintenance is not inconsistent with the antitrust provisions of the Constitution and Article 186 of the Revised Penal Code. The prohibition of agreements "in restraint of trade" only includes agreements that are unreasonable restraints of trade to be judged by the rule of reason. *Leegin* ruled that scholars have shown for quite some time already that minimum resale price maintenance had pro-competitive effects. It should not be subject to a *per se* standard which should only be used if the anti-competitive effect will always or almost always result. This is not to say that all minimum resale price maintenance agreements should be treated as lawful. However, a rule of reason standard should be used to see whether or not the particular restriction should be deemed lawful or not. As long as the franchisor can justify its use of resale price maintenance, then it will not be in violation of the Constitutional provision or Article 186 of the Revised Penal Code. It would only conflict with Section 87.2 of the Intellectual Property Code which made use of a *per se* rule.

(b) a maximum resale price

Maximum resale price maintenance, just like minimum resale price maintenance, had been recognized to have pro-competitive effects in *State Oil.*

(2) Whether or not franchisors can require the franchisees to purchase other products from the franchisor as a condition in the franchise agreement.

Even in the U.S., tying is still subject to a *per se* rule. Although one thing of note is that the complexity of the modified *per se* rule makes it more like a rule of reason standard. Just like resale price maintenance, it can be interpreted to be harmonious with Article XII, Section 19 of the Constitution and Article 186 of the Revised Penal Code. Additionally, using the persuasive authority of *Jefferson* and *Susser,* and either *Siegel* or *Principe,* even a "tying agreement" can be argued against a partial *per se* unlawful test and can be judged under the rule of reason. Under *Jefferson Parish,* it will be necessary to satisfy the requisites that there are two separate products involved, that there is sufficient monopoly power in the tying product, and that a not insubstantial amount of commerce is affected. *Principe* interprets that in franchising agreements, as long as what is being "tied" is an integral component of the business format, there exists no separate product. Using this line of reasoning, it can be said that most franchising agreements do not really have tying agreements in them.

(3) Whether or not franchisors can impose exclusive territorial restrictions and other non-price restrictions on the franchisees

Non-price vertical restraints have long been recognized to be judged under the rule of reason. This recognition has been given in *White Motor Co.* and was renewed in *Continental* where it was held that limitation of dealers to territories do not restrain trade because there is nothing keeping the customer from going to another territory or to another brand. In the E.U., a franchisor can even avail of a block exemption that will allow him to set up territorial restrictions.

(4) Whether or not franchisors can require franchisees to exclusively deal with them.

Exclusive dealing, according to *Tampa*, can be justified as long as it does not affect a substantial amount of the effective competitive market in its line of business. As to what constitutes substantial, *Jefferson* is the only U.S. Supreme Court Case that can provide guidance. In *Jefferson*, it was ruled that 30% was a substantial amount. Nonetheless, it must be noted that the doctrine has not been seen to be consistent enough to be persuasive.

Therefore, as an answer to the Article's general query, it is concluded that placing vertical restrictions in business format franchising agreements will not necessarily be inconsistent with the antitrust provisions of the Constitution and the Revised Penal Code. It will violate neither as long as there is a justifiable reason in the imposition of the restraint. The only conflict will be on certain prohibitive provisions of the Intellectual Property Code.

VI. RECOMMENDATIONS

It is recommended that Article 186 (1) of the Revised Penal Code be amended to read:

> Art. 186. *Monopolies and combinations in restraint of trade.* — The penalty of prision correccional in its minimum period or a fine ranging from 200 to 6,000 pesos, or both, shall be imposed upon:
>
> (1) Any person who shall enter into any contract or agreement or shall take part in any conspiracy or combination in the form of a trust or otherwise, in *unreasonable* restraint of trade or commerce to prevent by artificial means free competition in the market.

While it is true that such can be interpreted by tracing the legislative history of the provision to American jurisprudence and using the persuasive authority of *Standard Oil*, its inclusion in the provision will give Article 186 (1) statutory force. Such an amendment will also reflect and confirm the standard of the rule of reason in the Philippines.

It is also recommended that Article 28 of the Civil Code be amended to include violations for combinations in unreasonable restraint of trade as to allow franchisees who have been injured by unreasonable restraints of trade to sue for damages, to wit:

> Art. 28. *Combinations in restraint of trade*, and unfair competition in agricultural, commercial or industrial enterprises or in labor through the use of force, intimidation, deceit, machination or any other unjust, oppressive or highhanded method shall give rise to a right of action by the person who thereby suffers damage.

One of the things that can be noticed from antitrust cases is that most of them have been brought as a suit for damages rather than to criminally prosecute violators. Criminal prosecution takes valuable time from the victim, who by then is trying to recover the losses he has incurred. It will be reasonable to presume that most victims would not be willing to spend so much time to have someone incarcerated for a purely business practice, offensive as it may be. Thus, the only one left to enforce is the State, which in our case does not have a very good track record. Providing an avenue for victims to collect damages for their losses can promote the litigation of cases on antitrust, something that can help develop our own case law on the matter. This is the case in the U.S., where Section 4 of the Clayton Antitrust Act provides for threefold or treble damages.[297] It was recognized there that "the treble damages remedy gives private persons a powerful incentive to enforce the antitrust laws."[298]

It is also recommended that the illegal *per se* rules on vertical restraints used in Section 87 be repealed, namely Sections 87.1 (Exclusive Dealing), 87.2 (Resale Price Maintenance), and 87.3 (Non-Price Restraints).[299] As it is being emphasized over and over again, *per se* rules should only be used as an antitrust measure only if it can seen that the act will always or almost always be anticompetitive. These acts should not be deemed adverse to competition. Additionally, in line with the purpose of antitrust regulation, an additional provision that incorporates the concept of tying should be incorporated. A quick fix would be to transfer them to a special class that makes use of the rule of reason:

> Sec. ___ Provisions in Restraint of Trade. The following provisions shall not be considered adverse to trade if they have a reasonable purpose:
>
> (1) Those pursuant to which the licensor reserves the right to fix the sale or resale prices of the products manufactured on the basis of the license;

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297. 15 U.S.C. § 15.

298. AREEDA & KAPLOW, *supra* note 112, at 83.

299. INTELLECTUAL PROPERTY CODE, §§ 87.1-87.3.

(2) Those which impose upon the licensee the obligation to acquire from a specific source capital goods, intermediate products, raw materials, and other technologies, or of permanently employing personnel indicated by the licensor;

(3) Those that contain restrictions regarding the volume and structure of production;

(4) Those that limit the franchisee's activities to a particular territory; or

(5) Those that contain agreements to sell one product, but only on the condition that the buyer also purchases a different product, or at least agrees that he will not purchase that product from any other supplier. Such an agreement is reasonable if it seeks to protect the franchisor's industrial or intellectual property rights, or to maintaining the common identity and reputation of the franchised network, or specifications tends to be impractical.

If an unreasonable use of the vertical restraint is found, then the agreement would be considered adverse to trade and would fall under the "other clauses with equivalent effects" category of section 87.15.[300] In this manner, the Technology Transfer Bureau no longer needs to justify the existence of an exceptional case, having high technological content, or use of local raw materials, every time it is faced with a business format franchising agreement.

Another alternative is to include the above provision in a law specially created to regulate business format franchising agreements. This is more preferable since the unique character of business format franchising as well as the relationship of the franchisor and the franchisee, one that is not usually present in other distribution or vertical relationships, requires coordinated regulation.

300. *Id.* § 87.15.