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The Law and Economics of Vertical Restrictions: A Relational Perspective

Victor P. Goldberg*

Vertical restrictions between franchisors and their dealers have long been a thorny problem in antitrust law. Richard Posner's characterization of the case law as a "fiasco" and a "doctrinal shambles"[1] is echoed by many other commentators.[2] Perhaps partly because of the intellectual confusion in the area, the Supreme Court recently made an apparently sharp change in direction. In *Continental T.V., Inc. v. GTE Sylvania Inc.*[3] the Court reversed the decade-old *Schwinn*[4] per se doctrine, holding that at least some vertical restrictions deserve a rule of reason test. Whether this decision will prove a more durable precedent than *Schwinn* remains to be seen. Robert Bork, an enthusiastic supporter of the overthrow of *Schwinn*, has counseled caution in projecting the implications of *GTE Sylvania*,[5] and the FTC's interpretation of the case in its decisions regarding territorial restrictions by soft drink bottlers suggests that the magnitude of the change from the *Schwinn* standard indeed might have been exaggerated.[6] Even if *GTE Sylvania* is not subsequently overturned, the next few years will see a continuing flow of litigation to define the boundaries of the rule of reason test as applied in this new context.

To understand the nature of the franchise relationship and the way antitrust law deals with it, it is useful to depart somewhat from the conventional analysis in the economics and law of contract, in which

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1. R. POSNER, ANTITRUST LAW, AN ECONOMIC PERSPECTIVE 166-67 (1976).

2. *See, e.g.*, Baker, *Vertical Restraints in Times of Change: From* White *to* Schwinn *to Where?*, 44 ANTITRUST L.J. 537 (1975); Handler, *Twenty-Fifth Annual Antitrust Review*, 73 COLUM. L. REV. 415, 458-59 (1973); Pollack, *Alternative Distribution Methods After* Schwinn, 63 NW. L. REV. 595 (1968); Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243 (1975); Williams, *Distribution and the Sherman Act—The Effects of* General Motors, Schwinn *and* Sealy, 1967 DUKE L.J. 732.

3. 433 U.S. 36 (1977).

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

5. Bork, *Vertical Restraints:* Schwinn *Overruled*, 1977 SUP. CT. REV. 171.

6. *In re* Coca-Cola Co., 91 F.T.C. 517 (1978); *In re* Pepsico, Inc., 91 F.T.C. 680 (1978). The lone dissenter in these decisions stated: "[T]he majority decision comes close to establishing a *per se* standard of illegality where territorial restraints are imposed by leading firms in an industry." 91 F.T.C. at 598 (Comm'r Clanton, dissenting).

the archetypal transaction is the sale of a widget. In the franchise contract the parties enter into a long-term arrangement in which they interact, insulated to some degree from external market forces. Using Ian Macneil's terminology,[7] it is profitable to view the franchise arrangement as a relational exchange rather than as a discrete transaction.

Traditional economic analysis focuses on the aggregation of transactions into markets; it generally ignores the nature of the individual transaction and considers behavior within that relationship irrelevant. From a relational exchange perspective, behavior within the relationship is an important element of concern. In part I, I develop the broad elements of a relational exchange perspective. Part II fosters understanding and appreciation of this perspective by focusing on one particular element of relational exchange—the barriers to exit from the relationship—and the means for altering those barriers. Part III demonstrates the impact of a relational exchange perspective on antitrust analysis. Indeed, recognition of relational concepts in *GTE Sylvania* led the Court to conclude that some vertical restrictions can be significant elements in an efficient marketing system. Nonetheless, a liberal policy regarding vertical restrictions must be tempered by recognition that private and social costs and benefits may not coincide. I therefore close part III by briefly discussing a number of reasons for the possible divergence of private and social efficiency.

Parts IV and V discuss the issue of relational governance, and show it to be a natural extension of the relational exchange perspective. In confronting and resolving conflicts of perceived legitimate interests, courts often pursue relational governance goals, such as dealer protection. Part IV recognizes that courts must be able, when necessary, to redefine rights in response to or in anticipation of changes in the perceived legitimacy of those rights. However, the *unarticulated* pursuit of relational governance goals has contributed significantly to the confusion in the case law. A relational exchange perspective demands articulation of those goals, which would inject some intellectual order into the decisions. In part V, using as an example the goal of protecting franchisees from termination, I suggest how antitrust laws might accommodate the pursuit of legitimate, articulated relational governance goals.

7. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 Nw. L. Rev. 854 (1978) [hereinafter cited as Macneil, *Contracts*]; Macneil, *A Primer of Contract Planning*, 48 S. Cal. L. Rev. 627 (1975) [hereinafter cited as Macneil, *Primer*]; Macneil, *The Many Futures of Contracts*, 47 S. Cal. L. Rev. 691 (1974) [hereinafter cited as Macneil, *Many Futures*].

I. Relational Exchange

Contracts often provide for long-term, complex relationships between the parties.[8] Examples include long-term construction contracts, requirements contracts, franchise agreements, warranties, country club memberships, collective bargaining agreements, the complex network of contracts that taken together make up the firm, government-funded basic research projects, and, in a less commercial vein, marriage. Indeed, all social interaction takes place within an elaborate network of relationships. Even an apparently simple contract between two parties for the sale of the aforementioned widget, for example, is conditioned by both legal and nonlegal relationships surrounding the contract. The performance of the parties influences their reputation with each other and with other potential trading partners. Furthermore, their conduct is judged by standards that depend on past social relationships; in a society in which parties presume others to be untrustworthy, exchange will be much more difficult to arrange than in a society in which meeting reasonable contractual obligations is the norm. These past and future relational factors in turn both influence and are influenced by the legal relationships within which the contract is embedded (including the validity of the precontract title to both the widget and the cash).

If we are to make generalizations about exchange relationships, this picture must be drastically simplified lest extraneous detail overwhelm us. Traditional economic analyses generally embody an implicit notion of contract that suppresses virtually all relational elements. I will try to rectify this by presenting a stylized picture of exchange that is simple enough to be tractable, yet is sufficiently complex to illustrate the essential characteristics of relational exchange.[9]

8. The word "contract" can be misleading since it suggests the existence of a formal document that accurately describes the relationship; in fact, there may not be a formal document, or the formal document may bear little resemblance to the actual structure of the relationship. Macneil includes all projections of exchange over the future in his definition of contract, *see* Macneil, *Many Futures*, *supra* note 7, at 720, and the usage here is consistent with his. When it is not likely to be confusing I will use "contract," "agreement," and "relationship" interchangeably.

9. I have developed aspects of the framework for this analysis in prior works. Goldberg, *Protecting the Right to be Served by Public Utilities*, in 1 RESEARCH IN LAW AND ECONOMICS 145 (R. Zerbe, Jr. ed. 1979); Goldberg, *Competitive Bidding and the Production of Precontract Information*, 8 BELL J. ECON. 250 (1977) [hereinafter cited as Goldberg, *Competitive Bidding*]; Goldberg, Book Review, 1 HASTINGS INT'L COMP. L. REV. 215 (1977) [hereinafter cited as Goldberg, Book Review]; Goldberg, *Toward an Expanded Economic Theory of Contract*, 10 J. ECON. ISSUES 45 (1976) [hereinafter cited as Goldberg, *Expanded Theory of Contract*]; Goldberg, *Regulation and Administered Contracts*, 7 BELL. J. ECON. 426 (1976) [hereinafter cited as Goldberg, *Administered Contracts*]; Goldberg, Resale Price Maintenance and the Federal Trade Commission: The Lenox and Magnavox Cases (1979) (unpublished report to the FTC; copy on file at the *Texas Law Review*) [hereinafter cited as Goldberg, Resale Price Maintenance].

For additional major developments of the relational framework, see O. WILLIAMSON, MAR-

Suppose that two parties at the formation stage of an agreement contemplate entering a contract with an anticipated termination date. They can, however, prematurely terminate the contract at various times during the relationship. The parties have competing options available, both at the formation stage and within the relationship. At the formation stage the parties choose rules to structure their relationship. The choice of rules and of trading partners depends on the anticipated outcomes.

Traditional economic analysis generally ignores the nature of the individual transaction and focuses attention on the aggregation of transactions into markets. By working backwards it is possible to determine the type of exchange relations implicit in the standard analyses. These analyses implicitly assume that the state has specified rights that it protects perfectly and costlessly, and that the state is a perfect enforcer of all contracts. In the simplest case—contemporaneous exchange—the exchange is fully consummated at the formation stage. This case, in principle, is no different from one in which the relation takes place over a long period of time, but the outcomes are totally independent of the behavior of the two parties themselves. The parties bring the future into the present by acting on the basis of an anticipated distribution of outcomes and attitudes toward risk. Instead of exchanging goods the parties traffic in contingent claims.

Outcomes, however, often depend upon the behavior of the parties. *X* may have agreed to subject himself to *Y*'s discretionary power concerning certain aspects of the agreement. *X* may find that the incentives change after the relationship has begun, moral hazard[10] being one manifestation of this. Outcomes may depend on strategic behavior of the parties. Suppose that as the relationship unfolds the terms on which *X* and *Y* can deal with parties outside the relationship remain the same as they were at the formation stage. That is, if customer *X* faced four equally situated sellers at the formation stage, he would face precisely the same situation once the relationship has begun; that *Y*

KETS AND HIERARCHIES: ANTITRUST IMPLICATIONS (1975); Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978); Macneil, *Contracts*, *supra* note 7; Macneil, *Primer*, *supra* note 7; Macneil, *Many Futures*, *supra* note 7. *See also* Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979) [hereinafter cited as Williamson, *Transaction-Cost Economics*]; Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PA. L. REV. 953 (1979) [hereinafter cited as Williamson, *Market Restrictions*]; Williamson, *Franchise Bidding for Natural Monopolies—In General and With Respect to CATV*, 7 BELL J. ECON. 73 (1976) [hereinafter cited as Williamson, *Franchise Bidding*].

10. "Moral hazard" refers to the modification in *X*'s behavior that results from this change in incentives. *See* Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941, 961 (1963).

won the initial contract would give it no advantage or disadvantage as compared with its competitors in subsequent periods. If each party faces the same competitive terms at all points within the relationship as it did at the formation stage, then the long-term agreement is, in effect, converted into a series of spot contracts.

Most standard economic analysis implicitly assumes that outcomes depend only on exogenous risks, or that endogenous risks can be offset by spot contracting.[11] Macneil refers to this kind of exchange as being in the "discrete transaction" mode.[12] Treating exchange as a discrete transaction directs attention to three types of questions at the formation stage: (a) how do economic actors choose from an array of options? (b) what market outcomes will result from the simultaneous choices of individual actors? (c) how do outcomes depend upon the nature of competition at the formation stage?

The discrete transaction is an ideal, never observed in the real world. Nevertheless, it is an extremely useful analytic construct and should properly be viewed as a special case—a subclass of exchange. My emphasis on relational matters in this essay should not obscure the fact that in many contexts explicit recognition of relational elements adds heat but sheds no light. The question is not *whether* we should suppress relational complexity in analysis; rather, the question is *when*.

In relational exchange, activity may to some degree be sheltered from market forces. Sheltering may be externally imposed upon the parties by law or custom. It may reflect the conscious decisions of the parties to structure a relationship to take advantage of the opportunities and account of the difficulties afforded by coordination and cooperation. Although in the discrete transaction framework behavior within the relationship is irrelevant, in the relational exchange perspective it is an important object of concern. This relational perspective leads to a rather different set of questions than those raised by standard economic analysis: (a) what determines the structure of a relationship? (b) how will the structure and outcomes change as time passes? (c) what will be the impact of these structuring decisions beyond the relationship (for example, on market power or price flexibility)?

If parties were omniscient and saintly, the structuring of their relationship would present no difficulty. But, in fact, they must make their decisions in a world in which information is imperfect and improvable

11. There are, of course, numerous exceptions. The analysis of moral hazard in the insurance context and of the internal organization of the firm are two significant ones. *See* Arrow, *supra* note 10; Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

12. Macneil, *Many Futures*, *supra* note 7, at 693, 725.

only at a price, and in which people behave strategically or opportunistically.[13] Moreover, they must recognize that both legal and extralegal enforcement of the agreement's terms by outside parties will be neither perfect nor costless. The traditional static efficiency questions that concern economists will often be relatively unimportant. Rather, the structure will reflect a number of interests generally ignored in the discrete transaction framework: enforcement, reliance, flexibility, and governance.

If we assume that the agreement reflects the balancing of the parties' interests given the tools available, their efficacy in different contexts, and the constraints facing the decisionmakers, then we have the framework for a predictive model. Under conditions *M* we should expect to observe structure *N*. I am not going to pursue this line of inquiry directly here because it is tangential to my main purpose. Nevertheless, some words of caution are in order. First, the parties can select any one of a large number of apparently dissimilar devices to pursue the same goal.[14] The rich set of alternatives makes prediction of the type of tool chosen a difficult task. Second, the parties can use a particular tool for very different purposes.[15] Third, it is essential to recognize that the structure observed depends crucially on the sociolegal context. A particular structure does not arise in an aseptic, neutral setting. Therefore, attempts to explain that structure on narrow economic grounds can be very misleading. For example, the widespread adoption of the practice of selling gasoline through independent franchised dealers carrying a single brand of gasoline suggests that there are strong economic reasons for oil companies to prefer this arrangement to full-fledged vertical integration. The analysis, however, simply cannot ignore the fact that the widespread adoption of franchising in the late 1930s was also strongly motivated by a desire to avoid chain store taxation, Social Security obligations, and labor legislation.[16]

13. For a detailed discussion of the factors that make relational exchange attractive, see O. WILLIAMSON, *supra* note 9, ch. 2.

14. For example, *X* can protect his reliance on *Y*'s continued supply of a good by using a liquidated damages clause, holding higher inventories, or by maintaining control over *Y*'s supply of an important input.

15. Percentage-of-the-gross pricing, for example, can be used to adjust a contract to changing circumstances, to discourage opportunitistic breach, *see* Hallagan, *Share Contracting for California Gold*, 15 EXPLORATIONS IN ECON. HIST. 196, 206-07 (1978), or to facilitate price discrimination, *see* Caves & Murphy, *Franchising: Firms, Markets, and Intangible Assets*, 42 S. ECON. J. 572, 578-81 (1976).

16. *See* AMERICAN PETROLEUM INSTITUTE, PETROLEUM-INDUSTRY HEARINGS BEFORE THE TEMPORARY NATIONAL ECONOMIC COMMITTEE 105-06, 401-03 (1942); 1 S. WHITNEY, ANTITRUST POLICIES 125 (1958). That thirty states have, since 1973, passed legislation barring the oil companies from owning and operating gasoline stations must also be taken into account. The

As a second example, Lenox's peculiar practice of terminating dealers suspected of price-cutting without giving them warning (or even telling them the reason for the termination)[17] would be inexplicable unless one recognizes that it was an attempt to meet the uncertain standard of legality established in *United States v. Parke, Davis & Co.*[18] Obviously, since a structure depends on both economic and legal factors, explaining observed structures by the former alone is a risky proposition. I stress this point here because it will be of critical importance in the discussion in part V regarding protection of franchisees from termination or the threat thereof.[19]

I must emphasize that I counsel caution, not despair. The problem is in many respects analogous to that of the biologist. Given some hard-to-identify environmental constraints, why do certain physical or behavioral characteristics enhance the likelihood of survival? The large number of dissimilar, but successful, survival mechanisms is analogous to the variety of apparently successful structures for relationships. I do not want to push the analogy too far, yet it does suggest that the relational perspective can impose at least a rough intellectual order on observed outcomes. Our ability to explain will be much better on the strategic level (the goals sought) than on the tactical (the particular technique or tool used in pursuit of those goals). In the next part I will describe the nature of a specific class of tactics—altering the costs of exit—and suggest how that class relates to various strategic goals.[20]

II. Barriers to Exit

Once the parties have entered into a long-term agreement, they will continually weigh the merits of remaining in the relationship against the benefits of exit. In discrete transactional analysis exit barri-

constitutionality of this legislation has been upheld. Exxon Corp. v. Governor of Md., 437 U.S. 117, 128 & n.18 (1978).

17. *See In re* Lenox, Inc., 73 F.T.C. 578, 585-88 (1968), *modified sub nom.* Lenox, Inc. v. F.T.C., 417 F.2d 126 (2d Cir. 1969), *enforced as modified*, 77 F.T.C. 860 (1970). For a detailed discussion of the Lenox marketing system and the FTC's investigation of it, see Goldberg, Resale Price Maintenance, *supra* note 9.

18. 362 U.S. 29 (1960). Similarly, Richfield's policy of requiring that the dealer buy a minimum of 75% of its gasoline from Richfield was adopted "on the advice of its legal department" following the lower court decision in United States v. Standard Oil Co., 78 F. Supp. 850 (S.D. Cal. 1948). In practice, the dealers purchased all their gasoline from Richfield. *See* Brief for Appellant at 21, 25, Richfield Oil Corp. v. United States, 343 U.S. 922 (1952).

19. *See* text accompanying notes 128-33 *infra*.

20. Continuing the biological analogy, goals at the strategic level correspond to goals such as the acquisition of adequate food, protection from predators, and reproduction, while adaptations at the tactical level correspond to specific behavioral or physical characteristics. "Classes of tactics" roughly corresponds to notions such as territoriality—a commonly observed set of behavior patterns that appears to affect survivability through a number of very different channels.

ers are unfortunate frictional elements that impede the functioning of natural market forces; ideally, they should be leveled. In the relational framework, however, barriers can be functional and parties often will find it in their mutual interest to alter the exit barriers for one or both of them. The height of the barriers at each point in time is thus a crucial decision variable for the parties when structuring the relationship. A wide range of techniques is available for influencing exit costs, and in this part I will give an indication of their diverse nature. Although the parties might want to raise or lower the barriers from their natural level, the discussion will, for expositional ease, focus on the former.

A. The Virtues of Exit Barriers

Before discussing the means, it will be useful to consider briefly the ends. Why might exit barriers be functional? In general—but with significant exceptions—if *X*'s exit costs are raised, he does not benefit directly from the increase. Rather, *X* gains because *Y* is willing to pay *X* for accepting the higher exit barrier an amount that exceeds the costs to *X* of enduring that barrier.

1. Enforceability.—Within the contract each party incurs costs and receives benefits at various times, but the timing of the streams of benefits and costs need not coincide. If at any point in the relationship *Y*'s anticipated benefits substantially exceed his anticipated costs, he is vulnerable to being held up by *X*, particularly if, at that point, *X* expects low benefits and high costs by adhering to the contract terms. By threatening breach, *X* conceivably can force *Y* to revise the contract until *Y*'s anticipated costs just equal his anticipated benefits, at which point *Y* will be indifferent between completing the agreement on the new terms or termination—that is, *X* can expropriate the quasi-rents.[21] The parties are, of course, disciplined by both legal (contract) law and extra-legal[22] (good will) restraints. In many instances, however, they will consider these restraints inadequate and will structure the arrange-

21. *See* Klein, Crawford & Alchian, *supra* note 9, at 298.

22. For example, *X* may suffer damage to his reputation by breaching the agreement. The premium he would have to pay in future dealings in this market is one of the penalties for exit. The prospect of future dealings either with this particular trading partner or within this market can be an extremely effective constraint on opportunistic behavior. Unreasonable breach or the unreasonable insistence on literal adherence to the contract terms will impair a party's reputation. This "good will" constraint will be less effective if: (a) the parties do not expect to deal with each other or within a particular market again; (b) the complexity of the relationship makes it difficult for an outsider to determine whether one party has acted unreasonably (thus, parties have an incentive to put up a smokescreen of countercharges); (c) the dispnte is over an nnusual issue that social norms only vaguely address; or (d) there are tremendous rewards for violating the social norms.

ment to enhance its enforceability by making the streams of costs and benefits for each party more nearly coincident (in this instance, lowering the costs of exit for *Y* and raising them for *X*).

2. Reliance.—If one party intends to make investments whose value is contingent upon continuation of the agreement, then it will want to protect its reliance by ensuring continuation. Franchisees invest in the franchisor's inventories, signs, and promotion. Franchisors train their dealers and provide specialized knowledge on business techniques. Neither party would incur these costs without at least some expectation that the relationship will continue long enough for him to recoup his expenditures.[23] Let us consider an example of a very different sort. Suppose a landowner is contemplating building a structure on his property. If after the structure is completed the state can take the property without compensation, he would be reluctant to make the initial improvement. Reliance on the continuity of the law is precisely analogous to reliance on the continuity of a contractual relationship. Without protection, certain investments will be unattractive. Thus, if we treat the law as a contract between the state and the individual, protection of the individual's reliance interest would entail making exit by the state very difficult. This characterization highlights an interesting aspect of the treatment of exit barriers in much economic analysis. There is a presumption in discrete transactional economic analysis that property rights should be defined on a one-shot basis and then protected by the state; exit barriers should be extremely high. In private contractual relationships, however, exit barriers are traditionally viewed as unfortunate frictional elements that ideally should be eliminated. This juxtaposition illustrates the similar role played by exit barriers in the two contexts. The benefits associated with the constancy of rights definitions carry over to the private protection of reliance. (Conversely, the costs associated with the overprotection of reliance in private agreements underscore the problems arising from overprotection of vested rights.)

3. Governance.—The initial agreement will, in general, be neither self-enforcing nor self-adjusting. Internal prices and simple adjustment rules (like indexing) can, of course, be prominent features of the agreements. The parties can supplement—or supplant—these passive de-

23. Enforceability and reliance overlap. Thus, if *Y* produces a custom-made machine for *X*, as *Y* nears completion, he will want to confront *X* with exit barriers that ensure completion of the agreement. Alternatively, we might say that *Y* is concerned with protecting his reliance interest in his investment in in-process inventory.

vices by more activist forms of governance, such as monitoring or policing,[24] authority, or voice.[25]

At various times during the long-term relationship, *X*'s short-run incentives may not induce performance fully consistent with the parties' long-run interests. An agreement that *Y* may police compliance by detecting and penalizing violations will enhance the value to *Y* of entering into the relationship.[26] An authority relationship, in which *X* agrees that certain future decisions regarding *X*'s behavior shall be made by *Y*, is an attractive device for postponing decisions until better information is available.[27] *Y* should be able to impose costs on *X*, both to facilitate policing and to exercise his authority. High exit barriers for *X* enhance *Y*'s ability to impose costs in two ways. First, if *X* could simply walk away without cost, he could ignore any particular punishment (such as a suspension or fine); however, if *X* is subject to substantial losses if he breaches, he would be vulnerable to *Y*'s threatened punishments—the deterrents become credible. Second, a high exit barrier can be a powerful deterrent in its own right. *Y* can use the threat of termination or nonrenewal (and the resultant costs to *X*) to influence *X*'s behavior.[28]

Mechanisms relying less on authority and more on consultation, discussion, or more generally, what Hirschman refers to as "voice"[29] may also be attractive. Parties may want to make exit costly because the availability of a low-cost exit option undercuts voice mechanisms. High exit barriers for both parties make certain methods of adjusting relationships and resolving conflicts more feasible by forcing the parties to work out their difficulties.[30]

24. *See* Alchian & Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 782-83 (1972).

25. *See* A. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 30-54 (1970).

26. *See* Alchian & Demsetz, *supra* note 24; Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FINANCIAL ECON. 305, 308, 313, 323-25 (1976). The definition of the policing function should be broad enough to include motivating *X* and educating him about thc benefits of foregoing the short-term gains.

27. *See* Simon, *A Formal Theory of the Employment Relationship*, 19 ECONOMETRICA 293 (1951). In the standard conception of a strong hierarchical authority relationship, the authority is concentrated in one party: the boss (employer or franchisor). Of course, the decisionmaker need not be a party; he could, for example, be an arbitrator. Nor need the same individual make every decision.

28. The parties usually expect franchise relationships to continue beyond the date specified in the contract. Nonrenewal is, thereforc, equivalent to termination.

29. A. HIRSCHMAN, *supra* note 25, at 30-54. Hirschman defines voice as "any attcmpt at all to change, rather than to escape from, an objectionable state of affairs, whether through individual or collective petition to the management directly in charge, through appeal to a higher authority with the intention of forcing a change in management, or through various types of actions and protests, including those that are meant to mobilize public opinion." *Id.* at 30.

30. *Id.* at 36-37. The contracting parties can, of course, be collectivities. High exit barriers

It is important to recognize that these goals can be conflicting. If *Y* wants to maintain authority over *X*, he will want to keep his own exit costs low, for fear that *X* will not take his termination threats seriously. *Y*'s low exit costs will discourage *X* from making investments in reliance on the agreement and will also discourage the development of voice mechanisms for resolving conflict.

B. The Techniques

A variety of devices is available for altering exit barriers. Penalizing exit or, identically, rewarding continuation, increases exit barriers. Leaving hostages or promising a pound of flesh are rather extreme ways for one party to assure the other that he will not back out. Less extreme methods include the use of collateral,[31] deferred rebates,[32] performance bonds, and liquidated damages.[33] A buyer could also agree to pay a premium for goods or services provided during the relationship. The sacrifice of that premium is a cost of breach for the seller; the higher the premium, the greater his exit barrier.[34]

One device used in franchising combines a nonrefundable franchise fee with an attractive stream of earnings,[35] enhancing the benefits to the franchisee of continuing the relationship (but producing the opposite effect on the franchisor). Franchisors sometimes provide critical inputs at a nominal or zero price. For years oil companies have leased pumps to their dealers at very low rentals.[36] The possible loss of the subsidized price deters exit by the franchisee. A free service that the franchisee would have to pay for if he were to terminate the agree-

may exist only at the collective level, not at the individual level. Thus, it may be very difficnlt to dissolve the relationship between the firm and its union or between the management and the stockholders, yet very easy for an individual employee or stockholder to leave.

31. *See* Benjamin, *The Use of Collateral to Enforce Debt Contracts*, 16 ECON. INQUIRY 333 (1978).

32. Alfred Marshall noted that steamship companies at the end of the nineteenth century adopted a policy of "withholding the rebate for a long time, in order to keep the shipper in what he regards as bondage." A. MARSHALL, INDUSTRY AND TRADE 439 (1919).

33. *See generally* Macneil, *Primer*, *supra* note 7, at 666-701.

34. *See generally* Becker & Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1, 9-13 (1974); Gintis, *The Nature of Labor Exehange and the Theory of Capitalist Production*, 8 REV. RADICAL POLITICAL ECON. 36, 43 (1976); Klein, Crawford & Alchian, *supra* note 9.

35. One survey found a positive correlation between franchisee income and the size of the franchise fee, which is consistent with my analysis. U. OZANNE & S. HUNT, SENATE SELECT COMM. ON SMALL BUS., 92D CONG., 1ST SESS., THE ECONOMIC EFFECTS OF FRANCHISING 123 (Comm. Print 1971).

36. *See, e.g.,* FTC v. Sinclair Ref. Co., 261 U.S. 463 (1923); 1 S. WHITNEY, *supra* note 16, at 108-09; *Investigation of Concentration of Eeonomic Power: Hearings Before the Temporary National Economic Comm.*, 76th Cong., 2d Sess. 8495-96 (1940) (testimony of Sidney A. Swensrud).

ment has the same effect.[37]

Covenants not to compete are commonly used.[38] Franchisees can agree that upon termination they will not, for a number of years, enter a similar line of business within a certain distance from the initial location. On termination, the franchisee thus sacrifices any good will or specialized knowledge of the geographic area and product market for the duration of the covenant; moreover, he may suffer relocation expenses. These potential losses deter exit by the franchisee.

Sharing contracts represent a quite different method for discouraging exit. If the franchisee is paid a flat rate for providing retail services and it turns out that the market is much more attractive than anticipated, the franchisor has an incentive to terminate the agreement. However, if the pricing formula enables him to share the success of the market, termination is less attractive. There are numerous variants on this sharing concept. Royalties based on a percentage of the gross are common, especially in fast food franchising.[39] Oil companies commonly lease service stations to dealers, basing the rent on a fixed price per gallon sold. Resale price maintenance fixes both the price to the dealer and his selling price, thereby establishing a sharing rate. Arguably, any effect of these sharing arrangements on the attractiveness of exit is ancillary to other effects, such as facilitating discrimination, sharing risk, and altering incentives. Even if that is true as a general proposition, Hallagan's recent study of share contracting for gold suggests that, in at least one instance, discouraging exit was of paramount importance.[40]

Another way to influence the attractiveness of exit is to link the relationship to others.[41] *Y*'s vulnerability to *X*'s threat of termination is reduced if *Y* can impose reciprocal costs on *X* in another relationship. Reciprocity is one technique for providing mutual incentives to perform.[42] In other words, a party's vulnerability to the threat of termination is increased when the threat is linked to complementary rela-

37. *See* United States v. Richfield Oil Corp., 99 F. Supp. 280, 295 (S.D. Cal. 1951). Richfield agreed with most of its independent dealers to paint the service station with its own colors and insignia at no cost to the dealer. If, however, the dealer terminated the franchise, he became liable for the cost of painting.

38. *See* U. OZANNE & S. HUNT, *supra* note 35, at 250. Of all sampled agreements, 52% contained franchisee restrictions based on distance, and 60% contained restrictions based on time.

39. *Id.* at 215. The survey found that 90% of the contracts in the sample included royalty fees based on a percentage of the gross.

40. Hallagan, *supra* note 15, at 207-09.

41. Note that this is one way of characterizing the discipline of continuous dealings (or concern for one's reputation). Expected future dealings with this particular party or with others police performance of a particular obligation.

42. *See* Klein, Crawford & Alchian, *supra* note 9, at 304-05.

tionships.[43] GTE Sylvania's termination of Continental T.V.'s franchises is an example.[44] Upon termination GTE Sylvania instructed the firm that serviced its floor plan financing to demand payment from Continental. When payment was not forthcoming, it instructed the firm "to bring suit, repossess all Continental's Sylvania merchandise, attach Continental's bank accounts and (although no lien was even asserted on anything other than a portion of Continental's Sylvania inventory) cause the United States Marshals to close and padlock Continental's main store and its warehouse."[45] The linkage can also take the form of collective action by individuals engaged in similar relationships—trade unions, tenant unions, franchisee organizations, and so forth. The individual worker's ability to impose costs on an employer is apt to be small; but if all workers agree to act in concert the firm will find that the cost of firing a worker has increased dramatically.

The range of devices available for altering exit barriers should now be obvious.[46] While the devices can be viewed as substitutes, it should be clear that they are not interchangeable parts. The appropriateness of a particular device depends critically on the context, often in subtle ways. Fortunately, for my immediate purposes I need not investigate the *choice* of technique. It is by recognition of the legitimate uses of these techniques that a relational exchange perspective has its impact on antitrust analysis. The following part suggests that vertical restrictions can indeed be significant elements in an efficient marketing system.

III. Franchising and Antitrust

The term "franchising" describes a diverse set of retailing arrangements. Business format franchising involves the licensing of a trademarked product, service, or method to a franchisee. Fast food outlets, muffler repair shops, and convenience groceries are examples. Traditional franchising generally involves the provision of specialized retail-

43. *See, e.g.,* United States v. Richfield Oil Corp., 99 F. Supp. 280, 287 (S.D. Cal. 1951).
44. *See* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).
45. Brief for Petitioners at 17, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). Petitioners also claimed that Sylvania tried to influence another of Continental's major suppliers to restrict credit. *Id.* at 18. For a somewhat different version of the events, see Brief for Respondents at 15-19.
46. I do not intend to provide an exhaustive list of possibilities. One further category does, however, deserve acknowledgement: loyalty (the final third of Hirschman's triumvirate). *See* A. HIRSCHMAN, *supra* note 25, at 76-105. An attachment to the relationship (patriotism, team spirit, labor solidarity, corporate identity) enhances the perceived value of remaining within the relationship.

ing services—automobile dealerships and service stations are examples.[47] In the traditional franchises the dealer often specializes in handling a small product line, carrying exclusively (or nearly so) the franchisor's merchandise; the franchisee's business identity is thus intimately related to the continuation of the relationship. At the other extreme, the franchise agreement may pertain to a product constituting a small element in the retailer's product line; the arrangement may be so casual that it is indistinguishable from routine transactions between strangers. For example, a manufacturer selling indiscriminately through any retailers willing to carry its product may routinely send these retailers a document labeled "franchise agreement" that states the parties' intent to deal with each other sometime in the future, but fixes only minor terms for these future transactions.[48]

By imposing vertical restrictions on franchisees—resale price maintenance, territorial restrictions, exclusive dealing, long-term contracts, tie-ins, and other devices—franchisors often have been found to violate the antitrust laws.[49] After briefly reviewing the state of the law regarding vertical restrictions, I will suggest how recognition of relational concepts can establish the reasonableness of certain restrictions.

A. The State of the Law—An Overview[50]

Resale price maintenance agreements have been per se violations of the antitrust law since *Dr. Miles Medical Co. v. John D. Park & Sons*.[51] Federal legislation[52] exempted agreements authorized under state fair trade laws, but Congress withdrew this exemption in 1975.[53] Franchisors could, under the *Colgate* refusal-to-deal doctrine,[54] enforce

47. *See* INDUSTRY & TRADE AD., U.S. DEP'T OF COMMERCE, FRANCHISING IN THE ECONOMY, 1977-1979, at 1-3 (1979). Franchise agreements are not always made with retailers. Franchise agreements with distributors (wholesalers) are common. Nevertheless, they are usually closely linked to another set of agreements involving the retailers. One significant exception to this is the soft drink bottler franchise between syrup manufacturers and bottlers.

48. Estimates generally place the share of retail sales through franchising at about one-third (excluding the extremely casual pseudo-franchises noted in the text). *Id.* at 11. About 35% of the franchised units are service stations; less than 7% are automobile and truck dealerships, but they account for about half of all franchise sales. *Id.* at 34.

49. Of course, not all the cases in these areas involve franchising. Long-term contracts frequently are used in commercial contexts quite apart from retailing. *See, e.g.,* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961); *In re* Great Lakes Carbon Corp., 82 F.T.C. 1529 (1973).

50. For a summary of the state of the law prior to *GTE Sylvania*, see L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST ch. 5 (1977); ABA ANTITRUST SECTION, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION (Monograph No. 2, 1977).

51. 220 U.S. 373 (1911).

52. McGuire Act, ch. 745, 66 Stat. 631 (1952) (repealed 1975).

53. Act of December 12, 1975, Pub. L. No. 94-145, § 2, 89 Stat. 801 (amending 15 U.S.C. § 1 (1970)).

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

a price maintenance system by announcing a policy of retail sales at a fixed price and refusing to deal with retailers who failed to maintain that price. Recent decisions, however, have limited the availability of *Colgate*. Virtually any active enforcement of the policy—including such simple actions as responding to a dealer's complaint that another dealer is not maintaining prices—undermines the *Colgate* defense.[55]

The courts have dealt with other restrictions less severely. While some restrictions, notably those binding service stations, were violations prior to 1967, the pre-*Schwinn* law generally was not hostile to nonprice vertical restrictions so long as the restrictions were not camouflage for horizontal market division.[56] The *Schwinn* Court went even further than the government had asked, ruling that when a manufacturer sold its product it relinquished its ability to dictate the terms of a subsequent resale.[57] The manufacturer could, however, retain control through vertical integration or some lesser form of integration such as agency. The decision engendered substantial criticism. Milton Handler's characterization was typical:

> *Schwinn* [was] a mischievous precedent which rested on a nonexistent principle of ancient property law, and was historically incorrect, indefensible as a matter of logic, and unjustifiable as a matter of economics. That case was unique in the annals of antitrust for the volume of futile and costly litigation it generated and for the degree of confusion with which it enveloped a branch of law which had theretofore been relatively free of uncertainty. The lower courts had thus been compelled to indulge in tenuous distinctions to avoid its harsh requirements and to apply its doctrine, when it could not be rationally distinguished, with reluctance and distaste.[58]

The restrictions condemned in *Schwinn* concerned the customers to whom wholesalers could resell: they could sell only in designated territories and only to Schwinn's franchised retailers. The lower court condemned the former restraint only;[59] the Supreme Court condemned the latter as well. In *GTE Sylvania*[60] dealers were franchised to sell

55. *See, e.g.,* L. SULLIVAN, *supra* note 50, § 139, at 392-95; Pitofsky & Dam, *Is the* Colgate *Doctrine Dead?*, 37 ANTITRUST L.J. 772 (1968).

56. *See, e.g.,* White Motors v. United States, 372 U.S. 253 (1963). Professor Sullivan, however, notes that in the 1950s and 1960s the government brought a number of suits based on vertical nonprice restrictions that ended in consent decrees granting the requested relief. L. SULLIVAN, *supra* note 50, § 143, at 402.

57. 388 U.S. at 378.

58. Handler, *Changing Trends in Antitrust Doctrine: An Unprecedented Supreme Court Term—1977*, 77 COLUM. L. REV. 979, 980-81 (1977).

59. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 342 (1965), *rev'd and remanded*, 388 U.S. 365 (1967).

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

only from particular locations. When Continental T.V. began selling from a Sacramento outlet at which it did not have a franchise, GTE Sylvania terminated the franchise at Continental's other locations. Continental sued, contending, among other things, that the location clause was a per se violation of the antitrust law. The trial court agreed,[61] but the court of appeals reversed,[62] attempting to distinguish the case from *Schwinn* by arguing that the *Schwinn* restraints applied to the customer, while the *GTE Sylvania* ones did not.[63] A customer was free to buy from Continental regardless of where that customer lived; however, he could buy from Continental only at those locations at which Continental was franchised to sell. Rather than apply this distinction, the Supreme Court chose to overrule *Schwinn*.[64] Nonprice vertical restrictions are no longer illegal per se; they are now subject to a rule of reason test.[65]

B. Marketing Efficiency

The Supreme Court in *GTE Sylvania* stressed that vertical restrictions have "redeeming virtues": by fostering increased distributional efficiency, the restrictions actually promote interbrand competition.[66] One can best appreciate this position—an approach that hinges on the recognition of relational concepts—by considering the alternative offered by the franchisee in *GTE Sylvania*: "The vice in what *Schwinn* and Sylvania did is . . . in the fact that the manufacturer's hand, rather

61. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 988 (9th Cir. 1976) (en banc), *aff'd*, 433 U.S. 36 (1977).

62. *Id.*

63. *Id.* at 988-90. The court also noted that on remand in *Schwinn* the district court allowed Schwinn to use location clauses in its retail franchise agreements. In addition, the Ninth Circuit cited several lower court decisions, including location clause cases, that had upheld particular practices not covered by the *Schwinn* rule.

64. Justice White, in his concurring opinion, preferred to avoid overruling *Schwinn* and instead adopted the Ninth Circuit's position, distinguishing *Schwinn*. 433 U.S. at 59 (White, J., concurring).

65. The majority, however, left untouched the rule of per se illegality for resale price maintenance. *Id.* at 51 n.18.

66. *Id.* at 54-57. The Court acknowledged the substantial scholarly support for the economic utility of vertical restrictions, citing Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pt. 2), 75 YALE L.J. 373, 403 (1966); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283, 287-88 (1975); and Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 L. & CONTEMP. PROB. 506, 511 (1965). The Court also noted that it had refused to impose a per se rule against vertical restrictions in White Motor Co. v. United States, 372 U.S. 253, 263 (1963). The Court based this refusal in large part on its uncertainty whether vertical restrictions satisfied the standard expressed in *Northern Pacific* for imposing a per se rule. *See* Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958) ("pernicious effect on competition and lack of any redeeming virtue"). It should be clear that the tie-ins at issue in *Northern Pacific* also fail to satisfy the per se standard formulated therein.

than the unseen hand of the market, is at the competition throttle."[67] The franchisee further asserted:

> The majority's view assumes that the manufacturer knows better than the market how dealers ought to be deployed and what services and facilities they should offer in order to maximize output. But this argument, like the comparable one in favor of resale price maintenance, assumes that the manufacturer will always know what is best and that his administered judgment about the ideal deployment of outlets across the nation will be more efficient than the deployment achieved through the myriad individual decisions by dealers who have invested in the distribution process. This assumption undercuts the primary policy commitment of the antitrust laws, and the conviction that individual market decisions are likely to be more sensitive, flexible and accurate gauges of the way resources should be deployed than any monolithic, administered decision.[68]

This argument applies with equal force (or lack thereof) to all "administered decisions," including those within firms. Society routinely isolates a tremendous number of transactions from the free play of impersonal market forces for a very persuasive reason—cost.[69] Intrafirm allocation (one significant manifestation of relational exchange) can be much cheaper than market-mediated exchange. If this were not true the survival of the firm that faces competition from the "market mechanism" would be difficult to explain.

The basic efficiency argument for vertical restrictions is straightforward. Manufacturers have a wide range of possible marketing strategies. They can engage in extensive national advertising, sell their products to all retailers, and de-emphasize point-of-sale selling effort. Or they can emphasize point-of-sale effort by door-to-door solicitation, in-store display and demonstration, or local advertising. Franchising is an attempt to induce point-of-sale effort and to influence the form that effort will take. Selling effort is not a service easily bought and sold in impersonal markets. The identity of the retailer is often important; substantial relation-specific investment is frequently required. Moreover, the quality of the service is difficult to monitor, and retailers have

67. Brief for Petitioners at 32, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

68. *Id.* at 58. Lawrence Sullivan was primarily responsible for the brief. He presents similar arguments in his hornbook. L. SULLIVAN, *supra* note 50, § 145, at 411-14. Ironically, the brief labels manufacturer control "paternalistic overreaching," while implicitly suggesting that the legal prohibition of vertical restrictions is not paternalistic. Brief for Petitioners at 58-60.

69. *See* Coase, *supra* note 11, at 390-93. Coase does note, however, that a firm may reach a size at which the costs of intrafirm transactions exceed the costs of market transactions. *Id.* at 394-97.

incentives to free ride on the efforts of others.[70] The structure of the franchise relationship reflects the franchisor's[71] efforts to cope with these difficulties.

The dealer must be able to capture some of the rewards of his selling efforts. With no shielding, each dealer has an incentive to free ride on the efforts of others, and virtually no incentive to provide the service. Dealers would, therefore, refrain from providing the selling services.[72] By partially shielding each dealer from competition from other dealers, the manufacturer can lessen the propensity to free ride.[73] Moreover, since the methods available to the manufacturer for shielding a dealer differ in the nature and extent of protection provided to particular dealer activities, the manufacturer can influence the mix of pre- and post-sale dealer services. If a manufacturer engages in resale price maintenance and sells to all retailers regardless of location, the retailers are likely to engage in those forms of nonprice competition that reward only the individual retailer, such as promoting the product within the store and granting the product relatively more attractive shelf space. Each retailer has little incentive to advertise since many other retailers with whom he competes would share the benefit. If, however, resale price maintenance were coupled with limited distribution—so that the dealer could expect little intrabrand competition—local advertising would be relatively more attractive.[74] Even in this sit-

70. Product reputation is a communal asset. If the costs of degrading quality fall primarily on the brand name, rather than on the individual dealer, dealers would find that failure to maintain the brand name would not impair their short-run interests.

71. The franchisor typically designs the franchise agreement and offers it on a take-it-or-leave-it basis to franchisees. This does not mean that franchisee interests are not considered, but that the franchisee plays a passive role in the structuring process.

72. A memo from Magnavox (which used resale price maintenance and restricted distribution) to retailers who carried both its product and competing lines (the competing manufacturers did not have restricted distribution policies) illustrates this point:

1. You are establishing a price from which the discounter starts cutting.
2. You loan your store's prestige to these discounted lines.
3. Your displays and showrooms and your sales people are giving free sales presentations to the discounters.
4. You are discouraging your own sales people who are losing their time and sale presentation to the discounter.
5. You are tying up capital and slowing down turnover that is needed in your Magnavox line in better displays (which is quite mediocre in most cases), an adequate back-up stock which in most cases, is far too weak.
6. Your advertising dollars spent irrespective of distributor participation are being capitalized on by the multitude of other business houses with the same lines even disregarding the discount houses.

Quoted in Goldberg, Resale Price Maintenance, *supra* note 9, at 57.

73. The Supreme Court specifically recognized the free rider problem in its *GTE Sylvania* decision. 433 U.S. at 55. For a general development of the free rider argument, see R. POSNER, *supra* note 1, at 148-50.

74. The manufacturer could prescribe cooperative advertising in lieu of territorial protection or in conjunction with partial protection. Under a system of cooperative advertising the manufac-

uation there can be major differences in retailing strategies. For example, both Magnavox television and audio systems and Lenox fine china used resale price maintenance and limited distribution. Magnavox employed discounts and other enticements to encourage dealers to stock only its brand; Lenox, however, preferred to market through dealers carrying a large number of competing brands.[75] The two strategies reflect differing evaluations of the costs of diluted representation of the brand and the benefits of spreading common marketing costs over a wider base.[76]

Protection from intrabrand competition requires an enforcement apparatus. The enforcement problem is similar to that facing any cartel: cheating must be detected and penalized. The greater the rewards for antigroup behavior, *ceteris paribus* (for example, the higher the margin in a resale price maintenance system), the more difficult it will be to maintain the structure. While the problems of running a cartel and a franchising system are analytically equivalent in this context, the policy implications are different. In the franchising context, the cartel-like activities are an integral element of the retailing system. There is no reason to presume, as courts habitually do,[77] that the restrictions in the franchising context have any of the anticompetitive characteristics associated with interbrand cartels: precisely the same enforcement apparatus would be appropriate if the retailers were all employees of the manufacturer.

Businessmen have developed numerous techniques for detecting and penalizing violations of the terms of the agreement. Judicial hostility—primarily toward resale price maintenance—has provided a strong impetus for creative enforcement efforts.[78] To facilitate detection of price-cutting, manufacturers can limit the dealers' ability to tie

turer agrees to pay a share of the dealer's local advertising expenses (generally for newspapers). Magnavox, for example, paid at least 50% for all its dealers, even if no local intrabrand competition existed. It paid 67% for some dealers (generally those in urban areas in which there was more than one Magnavox dealer). Other television manufacturers employed less selective distribution techniques and typically had higher cooperative sharing rates; the prevailing industry rate was 75%. *See* Goldberg, Resale Price Maintenance, *supra* note 9, at 60-62.

75. *See In re* Magnavox Co., 78 F.T.C. 1183 (1971); *In re* Lenox, Inc., 73 F.T.C. 578 (1968), *modified sub nom.* Lenox, Inc. v. FTC, 417 F.2d 126 (2d Cir. 1969), *enforced as modified*, 77 F.T.C. 860 (1970).

76. *See* Goldberg, Resale Price Maintenance, *supra* note 9, at 24-25. Magnavox was one of the few television manufacturers to engage in restricted distribution; part of its strategy was to aim for submarkets in which intensive retail selling efforts would be more productive. *Id.* at 50. In contrast, all of Lenox's fine china competitors employed restricted distribution. *Id.* at 24.

77. *See, e.g.,* United States v. Topco Assocs., Inc., 405 U.S. 596 (1972); United States v. Sealy, Inc., 388 U.S. 350 (1967); Dr. Miles Medical Co. v. John D. Park & Sons, 220 U.S. 373 (1911). *See also* R. POSNER, *supra* note 1, at 164-65.

78. The following discussion will not distinguish between legal and illegal behavior.

the sale of the product to something else, such as trading stamps, trade-ins, or complementary goods or services. They can inspect invoices, make cooperative advertising payments only for ads that include the manufacturer's desired price, hire detectives to "shop" dealers,[79] and encourage dealers to report violations by other dealers. If he detects a violation the manufacturer can require the offending dealer to compensate the dealer who lost the sale or who reported the violation.[80]

The ultimate sanction, of course, is termination. The greater the costs of termination to the dealer, the more susceptible he is to the franchisor's threat; the lower the costs of termination to the manufacturer, the more credible that threat. Dealers as a group generally approve an arrangement in which the franchisor can impose substantial termination costs on cheaters.[81] However, the difficulties in designing the termination sanction so that it will be employed only against cheaters make high termination costs less attractive for franchisees.[82] Conflict over the conditions of termination has been a significant problem in franchising and has left its imprint on the antitrust treatment of vertical restrictions.[83]

The foregoing analysis indicates the ways in which franchisors can combine vertical restrictions with enforcement to elicit various forms of intensive retailing effort from their dealers. The nature of the desired effort, the ability of the franchisor to induce that effort, and the techniques for structuring the relationship need not be the same for all industries, within industries, or even for two dealers carrying the same product of a single manufacturer.[84] This diversity does not imply

79. As late as the 1960s there existed specialized firms—shopping services—that shopped retailers to "determine the courtesy and efficiency of the employees and whether the price structure is being maintained." Goldberg, Resale Price Maintenance, *supra* note 9, at 73.

80. For example, Dictograph, a hearing aid manufacturer that granted exclusive territories and engaged in resale price maintenance, included in its franchise contract a specific compensation rate for infringing another distributor's territory—30% of the suggested retail price. Another hearing aid manufacturer, Maico, included a clause authorizing the manufacturer to settle disputes regarding infringement and to determine the amount of compensation to be paid. Magnavox had a general understanding with its dealers that if a dealer could procure an invoice from a customer showing that the customer had purchased the Magnavox product at a discount, Magnavox would pay the reporting dealer the amount of the discount and charge the discounter twice that amount. *See* Goldberg, Resale Price Maintenance, *supra* note 9, at 75-76.

81. Thus, a 1961 Magnavox advertisement to the trade stated that price cutting did not occur "because that firm uncompromising unrelenting firehorse, Frank Freimann [its president] will not let it develop, stamps it and you out the first time you try any fancy footwork." *Quoted in* Goldberg, Resale Price Maintenance, *supra* note 9, at 74.

82. Ozanne and Hunt report that of their sample of fast food franchisees, 75% felt that federal legislation restricting a franchisor's ability to terminate the agreement was necessary. U. OZANNE & S. HUNT, *supra* note 35, at 277.

83. *See* text accompanying notes 110-27 *infra*.

84. Retailing strategies in large urban centers, which support both large discounters and small specialty stores, are likely to be substantially different from those used in small, isolated

chaos. Ordered patterns can and do emerge, and some elements of them can be quite stable for lengthy periods. It is, however, equally important to recognize that many elements of the marketing program are in flux. The manufacturer is at best a groping optimizer, developing and modifying marketing strategies in response to feedback and a changing understanding of the efficacy of alternative approaches. The parties, and most emphatically, outsiders, do not know what is best; seemingly innocuous changes can have dramatic effects on the program's success.

I stress this last point for two reasons. First, courts and commentators frequently embrace a "less restrictive" test for vertical restrictions. If the same goal can be achieved by less restrictive means, then the more restrictive practice violates the law. Since primary-area-of-responsibility clauses and profit pass-overs are "less restrictive" in this scheme, they should not be illegal per se,[85] whereas so-called airtight territorial restrictions should be illegal.[86] But the franchisor who adopts more restrictive terms probably does so because he believes those terms are more efficacious. The high cost of violating an airtight clause may provide a better balance of conflicting interests than would the lower costs associated with the contractual alternatives. Indeed, the concept of an airtight clause is itself peculiar. The franchisor cannot *prevent* violation; it can only *discourage* it by adjusting the penalty and reward structure. Clever drafting can make the actual penalties associated with less restrictive terms equal to or even greater than those associated with more restrictive terms.

Second, the groping optimization metaphor emphasizes the role of the competitive *process* in producing competitive *results*. The search for efficient marketing tools is similar to the search for efficient production techniques.[87] The strong presumption against imposing external legal restrictions on the choice of production techniques should carry over to the marketing context, in which the outsider's knowledge of the effect of legal rules on outcomes is, if anything, even more deficient.

towns. For example, although Magnavox used resale price maintenance (with the same prices and dealer discount schedules) in both milieux, it varied other elements of its retailing strategy. *See* Goldberg, Resale Price Maintenance, *supra* note 9, at 59-69.

85. *See* White Motor Co. v. United States, 372 U.S. 253, 271-72 (1963) (Brennan, J., concurring).

86. Justice Brennan at least suggested this result in *White Motor*. *Id.* at 271. He noted in his concurrence that these restrictions—which impose a risk upon the dealer of *losing* his franchise if he sells across exclusive territorial boundaries—pose "serious hazards which might well deter any effort to compete." *Id.* *See generally* Pitofsky, *The* Sylvania *Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1 (1978).

87. The technique in the former is to combine contractual terms rather than physical factors of production.

C. *Qualifications*

The argument that vertical restrictions are significant elements in efficient marketing systems and that decentralized search will make efficient outcomes more likely is compelling. The argument does not, however, translate into an unambiguous policy recommendation. The contractual outcomes are efficient in a special sense. The agreement is the best the parties can do *for themselves*, given the constraints.[88] Whether it is also best for society is a different question; there are a number of reasons for the possible divergence of private and social efficiency. I will discuss these briefly under four headings: (1) cartelization; (2) entry barriers; (3) product differentiation; and (4) dynamics.

Whether one can design policies to cope successfully with these matters is still another question. My suspicion is that for the third and fourth categories, at least, the answer would generally be negative. These issues, however, are worth raising, for even if they are not now policy-relevant, they help put any policy recommendation in perspective. A very liberal policy toward vertical restrictions is not "clearly best"; rather it is "probably least worst."

1. Cartelization.—Either manufacturers or dealers can use vertical restrictions to facilitate cartel behavior. Manufacturers use vertical restrictions to mitigate the destabilizing effects of unrestricted dealer competition on the wholesale price structure. Professor Posner describes the dealer cartel:

> [T]he manufacturer may be the cat's paw of cartelizing dealers: the dealers want to fix prices and somehow coerce, or otherwise enlist, the manufacturer (perhaps they pay him) to act as their agent in administering a cartel, which he does either by fixing a uniform retail price for his goods or by assigning nonoverlapping sales territories to the dealers. It is not enough, however, for the dealers to enlist only a single manufacturer in their scheme. They must also enlist all (or at least most) of his competitors. Otherwise the only effect of the cartel may be to induce consumers to substitute other manufacturers' brands of the product in question.[89]

The dealers' ability to impose a cartel upon reluctant manufacturers has deteriorated noticeably in the last generation. Thus, while ob-

88. The "efficient marketing" argument presupposes that the industry's equilibrium marketing configuration will be optimal. If, however, multiple equilibria exist, the industry might have settled at a locally optimal, but globally suboptimal, marketing system. An exogenous shock—for example, an antitrust prosecution—might serve to shake up current, comfortable arrangements and facilitate the movement to a preferred state.

89. R. POSNER, *supra* note 1, at 148.

jections to vertical restrictions—especially resale price maintenance—on this ground may have been compelling in the 1930s, or even in the 1950s, they are much less so today. Retail druggists had been the primary supporters of resale price maintenance since the turn of the century and were the moving force behind the passage of fair trade legislation in the 1930s.[90] By threatening to boycott noncomplying manufacturers,[91] or by including nonsigner clauses in fair trade legislation,[92] druggists and other retailers were able to confront the manufacturer with an all-or-nothing choice: it could either sell through retailers using resale price maintenance or it could sell through other retailers.[93] Faced with this choice, manufacturers in a number of industries in the 1930s found the fair trade alternative more attractive. However, the rise of discount stores and the increased role of television advertising in providing marketing services dramatically altered the situation. Now, facing the same all-or-nothing choice on a statewide basis, most manufacturers would find their large discount store customers too valuable to lose and would be more likely to opt for free trade instead of fair trade. Price maintenance for geographic submarkets *within* states, however, could be feasible if the colluding dealers could induce manufacturers to keep the product out of the hands of local price cutters by restricting transshipment by arbitragers.[94]

2. *Entry Barriers.*—Williamson suggests that vertical integration by contract can have an additional influence on each market.[95] Poten-

90. *See generally* J. PALAMOUNTAIN, THE POLITICS OF DISTRIBUTION 90-106, 235-53 (1955). For a discussion of resale price maintenance in nondrug industries circa 1900, see R. HOWER, HISTORY OF MACY'S OF NEW YORK 1858-1919, at 349-60 (1943).

91. In 1906 the National Association of Retail Druggists (NARD) organized a Tripartite Agreement among manufactnrers, wholesalers, and retailers establishing "uniform retail prices through manufacturers' sales contracts binding distribntors to specified resale prices. Manufacturers were induced to sign contracts by a well organized program of blacklists, white lists, and boycotts by wholesalers and retailers." J. PALAMOUNTAIN, *supra* note 90, at 94. While this agreement was subsequently held to violate the Sherman Act, Jayne v. Loder, 149 F. 21 (3d Cir. 1906), the boycott weapon was still used effectively on occasion. For example, after Pepsodent withdrew from its California fair trade contracts in 1935, virtually all California druggists refused to sell Pepsodent; following a few months of drastically lower sales, Pepsodent not only agreed to sign fair trade contracts, but also contributed $25,000 to NARD in support of the campaign for fair trade acts. J. PALAMOUNTAIN, *supra* note 90, at 239.

92. Nousigner clauses require that if one retailer in a state signs a fair trade contract with a manufacturer, then all retailers in that state are bound by it even though they have not signed.

93. The manufactnrer could make the choice somewhat less extreme by marketing one brand through the fair trade channel and another brand of a similar product through the other marketing channel.

94. Ironically, today a nonsigner clause might make resale price maintenance less likely (assuming it were legal). Dealers would not be able to isolate the geographic submarkets in which fair trade would be feasible, nor would they have sufficient strength to force statewide adoption.

95. Williamson, *Market Restrictions*, *supra* note 9, at 955-56.

tial entrants in manufacturing want to be assured of the availability of dealers (and vice versa). If most dealers have exclusive dealing contracts[96] with existing manufacturers, the potential newcomer might find it necessary to enter at both levels simultaneously. Even if feasible, entry at two levels by a single firm may be more costly than independent entry at each level, for two reasons. First, the higher capital requirement of the potential entrant raises the cost of capital. Second, a firm with an endowment favorable to entry at one level may have to invest substantially to develop the capability for entry at the other level. These specialized investments in factors such as managerial teams will be more costly to it than to firms that already are capable of entry at the second level. "Nonconvergent expectations" may impede entry at a single level—that is, the entrant's decisions at one level may be incompatible with the interdependent decisions made at the other level. Thus, vertical integration, whether formal or contractual, may exacerbate entry barriers at both levels and thereby further restrict competition. To present a serious policy problem, however, Williamson emphasizes that concentration in one stage must be high (or effective collective refusal to deal must exist).

3. Product Differentiation.—Assume that cartelization is not a motive and that franchisors adopt vertical restrictions only to make their marketing activities more efficient. Unlike production economies, these marketing economies may nevertheless have some undesirable consequences. For example, the intensive retailing effort elicited by exclusive dealing may misrepresent the brand's quality. Further, if a high, nondiscounted price influences the perceived quality of a product, achieving a positive consumer response via resale price maintenance is not an obviously desirable achievement.[97] The maxim *de gustibus non est disputandum* need not serve as an insurmountable barrier to consideration of these, and similar, questions.

Comanor[98] has argued that product differentiation in general and

96. Williamson's emphasis on exclusive dealing contracts is probably misplaced. The key issue concerns the barriers to exit for dealers, regardless of the form of agreement.

97. High price can be an element of quality or an indicator of it. High price can enhance the snob appeal of the product. *See* Leibenstein, *Bandwagon, Snob, and Veblen Effects in the Theory of Consumers' Demand*, 64 Q.J. ECON. 183 (1950). Alternatively, in a world of inadequate information in which the various methods for developing information are costly, high price might be taken as one of many imperfect signals of product quality. The incentive for low quality producers to free ride on the signal complicates analysis of price as a quality indicator. For evidence that consumers do take price as an indicator of quality, see Cornell, *Price as a Quality Signal: Some Additional Experimental Results*, 16 ECON. INQUIRY 302 (1978).

98. Comanor, *Vertical Territorial and Customer Restrictions:* White Motors *and Its Aftermath*, 81 HARV. L. REV. 1419 (1968).

vertical restrictions in particular result in higher entry barriers and greater allocative inefficiency. While I think the evidence on this point is ambiguous at best, it at least calls into question the net efficiency effects of marketing economies that enhance product differentiation.[99]

The recent theoretical literature on imperfect competition in a world of imperfect information suggests that many of the welfare propositions derived from the model of perfect competition do not survive in a more complex environment. In particular, if marketing or customer search costs are positive, free entry will yield inefficient equilibria even for small deviations from the perfect competition model.[100] Whether or not one takes specific conclusions in the literature seriously, and in general I am skeptical, the overall message is still humbling. The presumption that the internally efficient marketing strategy will, with workable competition (easy entry), yield desirable outcomes on the industry level is a bit less secure.

But it is nonetheless difficult for courts to rely heavily on these conclusions in formulating policy toward vertical restrictions. There is little reason to believe that banning some subsets of marketing techniques, including particular vertical restrictions, would yield improvements in any dimension. These considerations demonstrate the need for a more cautious rhetoric in support of liberalized antitrust treatment of vertical restrictions. To go much beyond that, however, would seem irresponsible.

4. Dynamics.—Williamson's proposed policy for vertical restrictions provides a useful vehicle for illustrating another set of difficulties:

1. Absent a tightly oligopolistic industry, vertical restrictions of all kinds are lawful and can be presumed to promote transaction cost economies.
2. Uniform reliance on vertical restrictions of any kind—on price, territories, customers, or exclusive dealing—in tightly oligopolistic circumstances
   a. can be challenged on the grounds that these promote more effective interdependence; but
   b. such challenges can be met by showing that nontrivial losses of transaction cost economies would result.[101]

99. *See generally* WORCESTER, WELFARE GAINS FROM ADVERTISING: THE PROBLEM OF REGULATION (1978); Brozen, *Entry Barriers: Advertising and Product Differentiation*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 115 (H. Goldschmid, H. Mann & J. Weston eds. 1974); Mann, *Advertising, Concentration, and Profitability: The State of Knowledge and Directions for Public Policy*, in *id.* at 137.

100. For a summary of some of the recent work, see J. Stiglitz, Equilibrium in Product Markets with Imperfect Information (manuscript 1978) (copy on file at the *Texas Law Review*).

101. Williamson, *Market Restrictions*, *supra* note 9, at 993.

Suppose then that a particular industry can be characterized as tightly oligopolistic.[102] Under Williamson's policy, if a practice is adopted by one or a few firms, then it is lawful; if, however, it is adopted by all or most firms, then it is subject to a rule of reason.[103]

Should the rule of reason test take into account the costs of *undoing* the restrictions? If the remedy entails revision of the marketing system and that revision results in the destruction of relation-specific (primarily intangible) capital, how should those costs be reckoned? If we do include those costs, then the likelihood of a successful challenge will be low; indeed, the oligopolists will have an incentive to arrange their affairs to make dismantling an expensive proposition.[104] If the costs are not taken into account, then the firms are less likely to explore the merits of marketing innovations requiring substantial relation-specific investment. This problem parallels the "unscrambling eggs" issue in merger law;[105] arguably, an incipiency rule would reasonably balance the costs.

Suppose that only a few firms have adopted a particular restriction, and therefore the practice is deemed lawful. If the remainder then adopt that same practice, should every firm be subject to antitrust investigation, or only the latecomers? An exemption for the initial adopters encourages manufacturers to launch "preemptive strikes." The manufacturer will preserve his options by including all possible vertical restrictions in the franchise agreement (whether or not he enforces them). If, on the other hand, every firm is subject to prosecution, early adopters are vulnerable to the strategic threats of others. The nonadopters can threaten adoption, imposing a high cost on the early adopters—the possibility that they will have to dismantle their entire

102. This supposition raises some market definition difficulties that I shall set aside.

103. The second element of Williamson's proposal—that if a practice is widely adopted by the industry, its legality is determined by the rule of reason—also raises some interesting questions. *See* Williamson, *Market Restrictions*, *supra* note 9, at 975-85. Demonstrating the existence of nontrivial economies is, of course, difficult, especially when we ask, "Compared to what?" It is probably not difficult to show that some vertical integration by contract will be more efficient than reliance on impersonal markets. But how does one show that a territorial restriction is more efficient than, for example, a location clause? Williamson's rule of reason is likely to degenerate into the test frequently applied by courts: are there "less restrictive" devices for achieving the parties' legitimate goals?

104. In discussing predatory pricing by a dominant firm owning a fixed stock of a durable machine, Williamson argues against rules that entail "involuntary asset retirement" and thereby "waste goods having social value." Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284, 318-20 (1977). The destruction of intangible capital caused by dismantling a marketing arrangement is, in essence, an involuntary asset retirement. Williamson's recognition of these costs in the predatory pricing context does not carry over to his vertical restrictions analysis.

105. *See, e.g.*, L. SULLIVAN, *supra* note 50, § 216.

marketing system. The early adopter's asymmetric vulnerability will discourage early adoption, thereby impeding the innovation process.[106]

There is widespread agreement that vertical restrictions used to maintain a horizontal cartel should be illegal.[107] Assuming that the horizontal cartel is not a concern[108] (and leaving aside the relational governance issues addressed in the next two parts), a good argument can be made, along the lines suggested by Williamson,[109] for a tolerant policy toward vertical restrictions. The argument, however, is not as clean and neat as the efficient marketing explanation would suggest.

IV. Governing Relational Power and the Termination Sanction

The franchisor's power over its franchisees has been an object of judicial concern. Franchisors can use their power to impose costs as a sanction to enforce vertical restrictions. If a restriction is not a blatant violation of the law, courts have considered the franchisor's potential relational power or his actual use of that power in determining whether the arrangement goes beyond legal boundaries.[110] The courts, however, have also been concerned with the issue of power in another context. They have attempted to alter—or, more accurately, to govern—the relationship in an effort to redress certain perceived inequities. Judicial attempts to extend protection to dealers in an effort to correct an imbalance of power in the relationship provide examples of this sort of relational governance. In a number of instances, courts sympathetic to a perceived dealer plight have used the existence of a particular restriction as a pretext for extending protection. It is not so much the pursuit

106. Conceivably, the outsiders can even use the asymmetry to enforce cartelization; they can make clear to the early adopters that failure to conform to the cartel policy will result in punishment—imitation followed by antitrust prosecution.

107. Various forms of horizontal price fixing or market division are arguably functional; the per se rule is so well established in this context, however, that it must be accepted as an exogenous constraint on policymakers.

108. Vertical restrictions should also be suspect when used to siphon profits from nonprofit organizations to profitmaking firms. Contracts between car rental firms and public airports may have this characteristic. *See* Dollar Rent A Car Systems, Inc. v. Hertz Corp., 434 F. Supp. 513 (N.D. Cal. 1977). The problem is analogous to that of AT&T's ownership of Western Electric. Whether these problems should be dealt with by antitrust enforcement agencies or by other government bodies such as the CAB or FAA, I am not prepared to say. See Verkuil, *State Action, Due Process and Antitrust: Reflections on* Parker v. Brown, 75 COLUM. L. REV. 328 (1975).

109. *See* notes 101-03 *supra* & accompanying text. Williamson's position is virtually indistinguishable from that of Bork or Posner. *See* Bork, *supra* note 5; Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1 (1977).

110. *See, e.g.*, FTC v. Texaco, Inc., 393 U.S. 223 (1968); Atlantic Ref. Co. v. FTC, 381 U.S. 357 (1965); Simpson v. Union Oil Co., 377 U.S. 13 (1964); United States v. Parke, Davis & Co., 362 U.S. 29 (1960); United States v. Colgate & Co., 250 U.S. 300 (1919); Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211 (3d Cir.), *cert. denied*, 429 U.S. 823 (1976); Shell Oil Co. v. FTC, 360 F.2d 470 (5th Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).

of this dealer protection goal that has contributed to the confused state of the case law, but rather the *unarticulated* pursuit of it.

The courts have at times failed to distinguish between asymmetric power within the relation and asymmetric power at thc formation stage. Justice Black's *Perma Life*[111] decision is the leading example. Arguing that the illegal contract terms had been thrust upon the franchisees by a powerful franchisor, he stated:

> [The franchisees'] participation was not voluntary in any meaningful sense. They sought the franchise enthusiastically but they did not actively seek each and every clause of the agreement. Rather, many of the clauses were quite clearly detrimental to their interests, and they alleged that they had continually objected to them. Petitioners apparently accepted many of these restraints solely because their acquiescence was necessary to obtain an otherwise attractive business opportunity.[112]

That is like saying if *X* agrees to pay one dollar for a widget, the "restraint" that he pay one dollar is detrimental to his interest. One cannot simply choose some terms from a complex agreement and say that since those terms hurt one party, they were not agreed to.

Most potential franchisees have substantial choice at the formation stage. They have little or no capital—physical, human, or intangible (good will)—whose value depends upon entering into a contract with a particular franchisor.[113] Judge Aldisert put the issue into proper perspective in *Dunkin' Donuts*:[114]

> We do not imagine that many persons are, in any meaningful sense, forced to enter into franchise agreements. It may be that

111. Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 139 (1968). *Perma Life* began as a treble damages suit by a group of terminated dealers against the franchisor, Midas Mufflers. Since the franchisees had themselves signed the contracts that were alleged to be violations of the antitrust law, the lower court granted a summary judgment for defendant. The Supreme Court reversed and remanded, holding that the suit was not barred by the doctrine of *in pari delicto*. In allowing plaintiffs' claim for relief, the Court stated that many of the contract terms were accepted involuntarily. *Id.* at 139. The parties then settled out of court for a fairly modest amount. Midas did not revise its franchise agreements until two years after the decision, and industry sources suggest that the revision was not in direct response to this decision; those sources also suggest that the decision did not precipitate other suits by disgruntled Midas dealers.

112. *Id.*

113. A franchisee with specialized skills (perhaps, for example, a hearing aid dealer) may find his formation-stage choices sharply circumscribed. But that would be the exception. The district court in *Dunkin' Donuts* noted that plaintiffs (terminated dealers seeking class certification) included a former butcher, barber, teacher, automotive designer, and railroad conductor. The court recognized that some of the franchisees were multi-unit operators, but stated: "[W]e suspect preliminarily (and tentatively) that none of the franchisees has as yet reached a position of bargaining equality with Dunkin' Donuts." Ungar v. Dunkin' Donuts of America, Inc., 68 F.R.D. 65 (E.D. Pa. 1975), *rev'd*, 531 F.2d 1211 (3d Cir.), *cert. denied*, 429 U.S. 823 (1976). For a discussion of franchisee origins, see U. OZANNE & S. HUNT, *supra* note 35, at 110-12.

114. Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211 (3d Cir.), *cert. denied*, 429 U.S. 823 (1976).

> some do so because they have been deceived as to the terms, or the potential profitability, of the franchise; it may be that others do so because they lack sophistication and do not understand or appreciate the details of the bargain. More realistically, we would expect to find that an arrangement apparently reasonable at its inception begins to seem burdensome to the franchisee as the business is successfully established. Only from the successful business can the franchisor effectively seek a continuing return on investment; yet as the venture prospers, the franchisee, in time, may come to regard the arrangement as onerous, restricting his profitability.[115]

Rather than focus directly on the balance of power within the relationship, the courts instead have stressed the effect of the agreement on business independence and freedom of opportunity.[116] This formulation raises two obvious questions: what dimensions of independence are desirable and whose independence and freedom should be promoted? The plaintiff's brief in *GTE Sylvania* provides one answer to the first question:

> Independent small businessmen who have made an investment of capital, energy and hope in their own enterprises, ought to be able to make their own crucial decisions as to where to sell and what price to charge for their own merchandise, free of coercion, collusion and exclusionary practices. That is what the free enterprise system, which the Sherman Act protects, is basically about. This Court has consistently supported that goal of commercial freedom. . . . Sylvania, in Sacramento, displayed consummate contempt for this Sherman Act goal. If Sylvania's Sacramento conduct does not invoke the *per se* rule of *Schwinn*, neither Sylvania nor any other large firm need in the future doubt its ability to effectively throttle any small buyer with which it deals.[117]

This statement highlights the confusion that permeates the decisions. Dealers contract away much of their discretion, not because they are forced to do so by a powerful manufacturer, but because it is profitable to do so. Plaintiff's counsel argued, in effect, that dealers should be given independence in these dimensions whether they want it or not—but they should not be given control of the "crucial decisions" concerning the structuring of the relationship.[118] Being a dealer entails a set of

115. *Id.* at 1223.

116. *See* Bohling, *Franchise Terminations Under the Sherman Act: Populism and Relational Power*, 53 TEXAS L. REV. 1180, 1190-92 (1975).

117. Brief for Petitioner at 39, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). For variations on this theme, see *id.* at 26, 35, 43, 49.

118. That dealers face standard form contracts is not relevant. Franchisors have incentives to tailor their standard forms to attract franchisees, providing variety and choice at the formation stage.

inalienable rights, which might more properly be called inalienable burdens.

This is not to say that courts should allow dealers to contract away their discretion in all contexts. Surely, a reasonable court may find many supposed voluntary agreements objectionable. A slavery contract is an obvious example; another, as I will suggest in the next part, is a contract giving the franchisor an unlimited right to terminate the agreement. But restrictions on price and location are typically essential elements in the package that the dealer is buying.

Nor should courts be indifferent to the "indicia of independent ownership" stressed by the Supreme Court in both *Simpson*[119] and *Schwinn*.[120] The contractual relationships of the parties are embedded in a larger set of legal relationships. The parties, in effect, contract into a "status relationship" that determines their obligations to each other and to third parties.[121] The distinction between independent businessmen (franchisees) and employees often determines whether an individual is covered by workmen's compensation laws, collective bargaining legislation, social security, and so forth. The indicia of independence are properly taken into account in determining the boundaries between these statuses. These demarcations only serve, however, to determine whether cases should be included in the antitrust *jurisdiction*.[122] There is no reason to treat them as determinants of the propriety or legality of specific behavior or contract terms.

With whose independence and opportunity are the courts concerned? If an exclusive dealing contract is to be unlawful, is it because of its effect on franchisees or because it limits the opportunity of potential suppliers to sell to these franchisees? Do the courts want to protect dealers from the power of the franchisor or to protect the business opportunities of potential franchisees and suppliers? The latter concern is frequently expressed. In its brief in *Standard Stations*, for example, the Government argued:

> Appellant's exclusive dealing contracts completely destroy the opportunity of other sellers of similar products to compete for the patronage of the dealer outlets contractually tied to appellants. In addition, they deprive those outlets of the opportunity to buy in a competitive market. . . . Agreements which fence off from

119. Simpson v. Union Oil Co., 377 U.S. 13, 20-24 (1964).
120. 388 U.S. at 381.
121. *See* Rehbinder, *Status, Contract, and the Welfare State*, 23 STAN. L. REV. 941 (1971).
122. *X* may be an independent businessman for some purposes and an employee for other purposes. *Cf.* L. SULLIVAN, *supra* note 50, § 114 (discussing the role of status determinations in applying the doctrine of intra-enterprise conspiracy).

> competition a substantial segment of the market constitute in effect a compulsory boycott of competitors.[123]

The courts have, in fact, given substantial recognition to this interest by invoking such concepts as "competition on the merits" (to be encouraged), and "foreclosure"[124] and "clogs on competition" (to be discouraged).

If *X* agrees to sell a widget to *Y*, then of course this contract excludes *Z* from buying *X*'s widget and *W* from selling its widget to *Y*. Exclusion, in this sense, is the essence of contract. The transactions between *X* and *Z* or *W* and *Y* could nonetheless take place if the parties are willing to surmount the barriers to exit (incur the costs of breach). While parties to the widget contract would generally opt for low barriers, parties to a franchise frequently would not. Exclusion of outsiders would be a natural result of the structuring decisions of the contracting parties.

Why should the exclusion of outsiders be cause for concern? Putting aside the concerns about cartel behavior and industry entry barriers,[125] is there justification for extending protection to the outsiders' opportunity to compete? Outsider reliance in general should be negligible. If the outsiders have made no investment in reliance on their ability to deal on reasonable terms with one of the parties, then it is difficult to justify protecting their interest; exclusion does not entail a capital loss for the outsiders. A similar insider-outsider distinction arises in the union-employer relationship. The interests of outside employers (like those of potential suppliers in the present context) typically go unrecognized.[126] The interests of nonunion employees (like those of excluded potential franchisees) may raise greater difficulties, particularly if the union employees (franchisees) attain protection against termination.

The problem of balancing these two conflicting interests is by no

123. Brief for Appellee at 20, Standard Oil Co. v. United States, 337 U.S. 293 (1949).

124. Attempts by economists to analyze the foreclosure issue in a traditional efficieucy framework usually find little or nothing of concern. The courts, however, have typically been concerned with the boycott-like features of foreclosure.

125. *See* text accompanying notes 89-96 *supra*.

126. In the franchise context, the issue of outsider interest frequently arises in connection with tie-in arrangements, which in effect prevent outsiders from selling certain supplies to the franchisee. *See, e.g.,* FTC v. Texaco, Inc., 393 U.S. 223 (1968); Atlantic Ref. Co. v. FTC, 381 U.S. 357 (1965); Shell Oil Co. v. FTC, 360 F.2d 470 (5th Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) (tires, batteries, and accessories); Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211 (3d Cir.), *cert. denied*, 429 U.S. 823 (1976) (flour, paper products, and coffee); Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972) (chicken and paper products). Since many of the tied products are supplies that are not the central element of the franchise business, the appropriate analogy in the labor union context would be an employer's attempt, for example, to limit the provision of employee health insurance to one or two insurance companies.

means an easy one. I suspect, though, that given a proper statement of the problem, and recognizing the important relational elements of the franchise agreement, the courts and enforcement agencies can satisfactorily accommodate these interests; the current approach (invocation of the inalienable rights of businessmen) only obscures the conflict.[127]

V. Termination Protection and the Antitrust Framework

Redressing an imbalance of power in a relationship is certainly not the only legitimate goal of relational governance. In this section, I posit another—protecting dealers from termination—and suggest how that goal might be pursued within the existing antitrust framework.

A. *The Collective Action Puzzle*

Left to their own devices, parties would design the franchise agreement so that franchisors could easily terminate the franchisee. Notice requirements would be short, franchisees would receive little or no compensation for their reliance, and the franchisor would not have to prove cause. The franchisees would agree to these terms for a simple reason: it pays. If the law had initially given potential franchisees the right to tenure, they would have voluntarily "sold" it to the franchisor as a condition for entering into the agreement (or else they would have remained potential franchisees). However, when acting collectively, through either collective bargaining or political action, they pursue, and to a substantial degree attain, protection from termination. In this subsection, I hope to shed some light on this individual/collective divergence.[128]

The initial question is, of course, is there anything to explain? This itself is a difficult question since it is not easy to characterize that fictional world in which parties are indeed left to their own devices. Franchise agreements today inevitably reflect the legal and social context in which they must exist, and that context makes it very difficult

127. Bohling is one of the few commentators who have directly confronted the problem:

> In resolving the conflicting interests of existing and aspiring franchisees, the existing franchisee deserves a favored status. Any existing franchisee has invested time, effort, and capital in his business that generally cannot be recouped in the event of a termination. An existing franchisee develops certain skills and expertise in his business that may not be transferable to other enterprises. The aspiring franchisee sustains no comparable losses if franchisor discretion to terminate is curbed.

Bohling, *supra* note 116, at 1205.

128. The puzzle emerges in a number of other contexts as well. *See, e.g.*, A. DICEY, LECTURES ON THE RELATION BETWEEN LAW AND PUBLIC OPINION IN ENGLAND IN THE NINETEENTH CENTURY 265-66 (2d ed. 1914). Analysis of the question in the franchising context will, I believe, shed considerable light on the same issues in the employment context.

for some classes of franchisors (notably automobile manufacturers and oil companies) to terminate without good cause. We can, however, draw inferences regarding what a laissez faire contract today would look like by observing agreements made a few decades ago, when courts put greater weight on freedom of contract,[129] and by observing the franchisors' political activity. Casual empiricism suggests that prior to the 1950s most franchisors (especially in the automobile, gasoline, and hearing aid industries) considered the right to terminate on short notice and without cause extremely important.[130]

One explanation for this divergent behavior is inherent in the nature of relational exchange. At the formation stage parties may deliberately accept terms they do not like, expecting that some of these terms can later be changed. By entering into a long-term contract, parties in

129. In Ford Motor Co. v. Kirkmyer Motor Co., Inc., 65 F.2d 1001 (4th Cir. 1933), the court noted:

> While there is a natural impulse to be impatient with a form of contract which places the comparatively helpless dealer at the mercy of the manufacturer, we cannot make contracts for parties or protect them from the provisions of the contracts which they have made for themselves. Dealers doubtless accept these one-sided contracts because they think the right to deal in the product of the manufacturer, even on his terms, is valuable to them; but after they have made such contracts, relying upon the good faith of the manufacturer for the protection which the contracts do not give, they cannot, when they get into trouble, expect the courts to place in the contracts the protection which they themselves have failed to insert.

Id. at 1006. *See also* Bushwick-Decatur Motors, Inc. v. Ford Motor Co., 116 F.2d 675 (2d Cir. 1940). The courts' reluctance to intervene, however, was not absolute. *See, e.g.,* Shell Oil Co. v. Marinello, 63 N.J. 402, 408-10, 307 A.2d 598, 601-03 (1973):

> Where there is grossly disproportionate bargaining power, the principle of freedom to contract is non-existent and unilateral terms result. In such a situation courts will not hesitate to declare void as against public policy grossly unfair contractual provisions which clearly tend to the injury of the public in some way.
>
> . . . .
>
> We hold . . . that the provision giving Shell the absolute right to terminate on 10 days notice is void as against the public policy of this State.

130. The Ford standard agreement in the 1930s stated: "This agreement may be terminated at any time at the will of either party." This clause was included in the contracts litigated in *Kirkmyer* and *Bushwick-Decatur*. *See* note 129 *supra*. Some changes were made in the franchise in 1944 in response to wartime shortages. For details on the wartime experience, see J. PALAMOUNTAIN, *supra* note 90, at 156-57; A. SLOAN, MY YEARS WITH GENERAL MOTORS 294 (1963). For an interesting study of the 1956 congressional inquiry into automobile dealership arrangements, the legislative response, and subsequent events, see S. MACAULAY, LAW AND THE BALANCE OF POWER: THE AUTOMOBILE MANUFACTURERS AND THEIR DEALERS (1966).

While service station franchises have taken a variety of forms, oil companies have generally maintained the right to terminate quickly; indeed, in many instances the franchisee was also a lessee and could be terminated on as little as 24 hours notice.

In the hearing aid industry, Dictograph's standard contract, which was typical of contracts in that industry prior to 1950, required that Dictograph be responsible for certain dealer costs if Dictograph initiated the termination. However, an additional clause read: "[I]n event Distributor for any reason whatsoever violates or breaches this agreement, Company may at its option treat such a breach as termination of this agreement, as though the same were terminated by Distributor." Thus, by finding any violation of the contract by the distributor, the company could avoid liability yet terminate quickly and cheaply.

effect buy admission tickets to a game of skill in which they attempt to revise the rules in their favor without inducing the other party to quit. The parties can constrain this relational jockeying in their initial structuring decision, but there is no reason to believe they can eliminate it; nor is there reason to believe that the contracting parties will be equally vulnerable to redefinition. This explanation may be accurate today, but it is hard to imagine that franchisees could have had such optimistic expectations about this "game" forty or fifty years ago.

Given individual choice in contract terms, the marginal man will determine the nature of the contract—the earnings/security combination will be chosen so that the last franchisee is indifferent between his relationship and the next best alternative. If the differences between the marginal and average man are systematic, the resultant contracts will differ. These divergences are likely in the franchise and employment contexts (and no doubt in others). Average existing franchisees are likely to be older, face higher dislocation costs, and possess more firm-specific capital than the marginal franchisee. These influences lead to a greater demand for security when the franchisees act collectively.

Neoclassical economics suggests a simple explanation: collective action enables franchisees to attain a larger compensation package; the budget constraint shifts out. If job security is not an inferior good, then neoclassical economics predicts that franchisees will buy more of it when acting collectively. While a plausible explanation, I doubt its validity. Franchisees did not get much termination protection prior to the mid-1950s, regardless of their buying power.[131]

Collective action does not simply shift the budget constraint out; it also changes the relative prices facing the parties. That is, the contract might not require franchisors to prove good cause for termination because enforcement under existing law would be too expensive. The cost of proving a violation in the available legal forum exceeds the anticipated benefits; collective action, however, can provide a legal forum at a lower cost to the individual. Further, collective action reduces the cost of extralegal enforcement. The individual dealer acting alone is in no position to impose significant costs upon the franchisor. If, however, the individual relationship is linked to other similar ones, the col-

131. A variant of this explanation is more persuasive. If collective action will yield future rewards to the members of an organization, the individuals will want to increase the likelihood that they will have the opportunity to capture those rewards. Termination protection is thus a means for obtaining the fruits of collective action as well as an end in itself.

lective ability to impose costs through, for example, a strike or boycott can effectively enforce the individual dealer's agreement.

Thus, Justice Black's language in *Perma Life*[132] may not be complete nonsense.[133] The relative prices of the franchisees' desiderata vary as a function of the size and cohesiveness of the group. That individual franchisees voluntarily choose contract *X* does not mean they would choose that same contract if they faced the relative prices that obtain when franchisees act collectively. If those prices do differ substantially from those in the individual choice case, then the meaningfulness of voluntary, uncoerced acceptance of contract terms is surely called into question. Formation stage power in this sense influences the relative prices facing the parties and hence the terms of the agreement reached.

B. Protecting Dealers from Termination

Assuming, then, that franchisees in general want greater protection from termination, is there any reason for public policy to recognize that interest? While one could take elements of the preceding discussion and recast them in terms of social benefits and costs, I prefer to take a different tack here. Suppose that a franchisor acts in a manner perceived as an abuse of his power, or "unfairly" terminates a dealer. Rather than remain silent, the dealer may react by imposing costs on the perpetrator, society at large, or even himself.[134] He may expend an inordinate amount of resources in response to unfair treatment or the loss of legitimate rights, whether in a destructive manner or in pursuing legitimate avenues of political redress.

If everyone passively accepted unfair terminations, the most socially desirable policy[135] would perhaps be to let the parties determine contractually the franchisee's security. But that is an inappropriate policy when unfair terminations may engender destructive responses. Instead, since the parties' behavior at the formation stage results in unanticipated costs, we should evaluate policies by taking into account

132. *See* text accompanying note 112 *supra*.

133. The interpretation is probably too charitable; the opinion does appear to be genuinely confused. Nevertheless, if Justice Black's unarticulated assumptions as to the meaning of unequal bargaining power did encompass the notions developed in the text, his argument makes a bit more sense (although the decision would still be difficult to justify).

134. The reactions of a party to a contested divorce or a custody battle may be analogous. Professor Michelman's "demoralization cost" notion, I believe, includes such costs. *See* Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1214-18 (1967).

135. I purposely leave the criteria vague. It may be useful to define "socially most desirable" in terms of Pareto-superiority, but I want to avoid an unnecessarily narrow definition.

the additional costs[136] arising from unfair terminations.

Let me suggest another justification for relational governance that is a natural extension of the relational exchange approach. Parties to the social contract face problems of opportunism, changing circumstances, and so forth. They therefore require mechanisms that will, when necessary, redefine rights in response to, or in anticipation of, changes in the underlying distribution of power. To cave in to every threat of violence would, of course, be absurd. To be inflexible would be equally foolish. In Alfred Marshall's words, "Courage is misapplied when it struggles against the inevitable."[137]

The legal process will invariably confront and be forced to resolve clashes of perceived legitimate interests. Courts or other policymakers must anticipate changing perceptions of legitimate rights (and the willingness of parties to use extrajudicial means for pursuing them) and determine how these notions constrain judicial options. Within these constraints they have some leeway. Mark Tushnet's characterization of Oliver Wendell Holmes' conception of the judicial role is very much in this spirit:

> To Holmes, judges should determine where power actually resides in the society and, for essentially Darwinian reasons, should make decisions that reflect the existing distribution of power. Although Holmes did not say so explicitly his analysis suggests that if it is foolish to resist de facto social power, it is equally foolish to ignore clear indications of change in the distribution of power. Indeed, if judges are to have any creative impact on society, as Holmes thought they should, they must predict the future so that they might facilitate the emergence of nascent centers of power.[138]

I do not intend to describe the process by which legitimate rights emerge; nor shall I suggest how to determine that a right has emerged or how to predict which rights will emerge. The arts of lawyering and

136. These costs can be considered externalities. Pigou includes similar costs in his discussion of the divergence of marginal social and private costs. A. PIGOU, THE ECONOMICS OF WELFARE 186 (4th ed. 1962). I am uneasy about using the externality terminology since it evokes from economists a set of Pavlovian responses that tend to confuse the issue. I anticipate with some dread a paper on the optimal tax to minimize the excess burden of industrial strife or international aggression.

137. A. MARSHALL, *supra* note 32, at 588.

138. Tushnet, *The Logic of Experience: Oliver Wendell Holmes on the Supreme Judicial Court*, 63 VA. L. REV. 975, 1030 (1977). *See also* F. FRANKFURTER & N. GREENE, THE LABOR INJUNCTION (1930). In a similar vein, Edward Banfield argues: "[T]he essential tasks of political leadership . . . are, first, to find the terms on which ambitious, vindictive, and rapacious men will restrain one another, and, beyond that, to foster a public opinion that is reasonable about what can and cannot be done to make the society better." *Quoted in* Wall St. J., June 5, 1978, at 18, col. 5.

judging consist largely of the application of inchoate rules of thumb in response to these questions. One can duck these general questions yet still give reasonably confident answers to specific ones. Thus, it is quite probably true that in the United States in the last quarter of the twentieth century, the perceived legitimacy of the dealer's right to protection from termination on other than good faith grounds and limitation of the franchisor's discretionary power in certain other areas have become realities to which the law will have to adjust. It is almost certainly true that we have at least passed the threshold at which a reasonable—or reasonably innovative—judge could plausibly recognize those restrictions on the franchise relationship.

C. *Antitrust and Relational Governance*

If the law is to provide increased protection to franchisees, it need not do so under the banner of antitrust. Rather, we might modify contract law or carve out statutory exemptions from it. Indeed, there have been many attempts outside the antitrust arena to extend protection to dealers.[139] I am not now advocating that antitrust law incorporate relational governance goals, nor am I now defining or developing those goals. Rather, I confine my remarks here to the modest question: *If* we want to pursue relational governance goals within the existing antitrust framework, how might we do so? If antitrust is to be used as a tool for relational governance, it is essential that this goal be disengaged from the economist's traditional antitrust concerns. That is, there should be no need to show public injury or to weave elaborate fictions as to why certain acts are inherently offensive.[140] If the franchise relationship concerns only a small part of a franchisee's busi-

139. Legislation at the federal and state levels has given some protection to automobile dealers, and numerous states have passed legislation protecting service station operators. Legislation governing other franchise relationships has been proposed; in the 1977-1978 session of the California legislature, 16 bills concerning franchising were introduced, including one that would have established a Franchise Relations Board—a quasi-judicial board to regulate ongoing franchise relationships. Courts have also invoked doctrines of good faith and unconscionability to protect dealers from termination, even though their contracts were apparently terminable at will. *See* Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465; Horton, *Legal Remedies of a Distributor Terminated Pursuant to a Contractual Provision of Termination Upon Notice*, 3 CREIGHTON L. REV. 88 (1970); INDUSTRY & TRADE AD., *supra* note 47, at 20-28. *See generally* Bohling, *supra* note 116; Krischer, *Franchise Regulations: An Appraisal of Recent State Legislation*, 13 B.C. INDUS. & COM. L. REV. 529 (1972); Comment, *A Tempest in a Chicken Bucket: Some Reflections on Franchise Regulation in California*, 17 U.C.L.A. L. REV. 1101 (1970).

140. Bohling discusses the demise of the public injury requirement. Bohling, *supra* note 116, at 1195-96. Public injury should, of course, remain a requirement if the issue is not one of governance. Bohling also develops a "relational power" test that focuses on the "monopoly" power a franchisor enjoys in relation to his franchisee. *Id.* at 1229-40. Market power, as conventionally defined, is irrelevant.

ness and he is not extremely vulnerable to termination threats, it seems reasonable not to extend him protection (*Schwinn* and *GTE Sylvania* would fall in this category). When vulnerability is great, however, and the potential for explosive conflict is high, the relationship should be subject to extra-contractual review (automobile dealers and service station operators would fall in this category). Drawing the line between these categories will not be easy, but making such fine distinctions is precisely what lawyers do well. The trick is to channel those line-drawing skills so that the distinctions will have some relation to articulated policy goals.

A terminated dealer can currently bring a private antitrust suit for treble damages plus legal fees. This penalty is surely excessive if only relational governance goals are involved. An alternative approach, which I believe can be implemented without amending the antitrust laws, begins by confining the treble damages remedy to instances of public injury. Relational governance can be restricted to section 5 of the FTC Act,[141] which addresses (among other things) "unfair practices." This does not mean, however, that the FTC should adjudicate all contested franchise terminations. Rather, its primary role should be suggesting and approving "umpire" or arbitration[142] plans for implementation on a firm or industry level. It might then serve as an appellate body for the disgruntled losers in these semiprivate forums. Or the plans might be designed to send appeals directly to the courts.

If adverse effects on interbrand competition are possible, then the courts must consider two trade-offs. First, if a particular act could result both in reduced interbrand competition and more efficient marketing, the courts must balance these two interests. Second, the public injury goals may conflict with the relational governance goals. (A franchisee "union," like a labor union, might facilitate monopolizing at the industry level.)[143] Courts could resolve these tensions with a per se rule prohibiting various vertical restrictions if the franchisor's industry is concentrated (because a rule of reason examination is likely to be both

141. 15 U.S.C.A. § 45 (West 1973 & Supp. 1979). A finding against the defendant in a § 5 proceeding does not necessarily establish liability for subsequent private treble damage actions. *See* P. AREEDA, ANTITRUST ANALYSIS 633 (1974).

142. *See* Sampson, *Arbitration Clauses in Distribution Agreements*, 28 BUS. LAW 627 (1973); Whittaker, *The General Motors Dealer Relations Umpire Plan*, 28 BUS. LAW. 623 (1973). For a general discussion of the use of arbitration agreements in extended business relationships, see Aksen, *Legal Considerations in Using Arbitration Clauses to Resolve Future Problems Which May Arise During Long-Term Business Agreements*, 28 BUS. LAW. 595 (1973).

143. *See, e.g.,* United Mine Workers v. Pennington, 381 U.S. 657 (1965) (agreement between union and employer-operators to secure uniform labor standards throughout industry not exempt from antitrust laws).

expensive and inconclusive).[144] More plausibly, a reasonable weighting of the issues should produce a more tolerant policy, along the lines suggested by Williamson.[145]

VI. Conclusion

I have tried in this essay to shed some light on a woefully confused area of the law. The analysis of vertical restrictions in antitrust case law in the years prior to *GTE Sylvania* has been, to put it charitably, unimpressive. That poor performance can be attributed, in part, to judicial attempts to pursue relational governance goals while justifying their decisions on other grounds. Economic analyses in the last two decades have provided a better understanding of the functional role of vertical restrictions,[146] but have generally paid little attention to relational governance issues, treating them either as beyond the proper scope of antitrust, or as matters to be decided by voluntary agreement between private parties, or both.[147] I believe the relational exchange framework provides a deeper understanding of the role played by the various restrictions. I have shown why these issues are of public concern,[148] why they arose in the antitrust context, and how antitrust law might usefully distinguish them from its other concerns.

I have been more concerned with sorting out the issues than with advocating a position. There is, as I have tried to make clear, a considerable range over which reasonable people might differ. I hope that my analysis has enhanced the likelihood that the subsequent debate will be conducted within that range.

144. *See* note 6 *supra*.

145. *See* text accompanying notes 101-03 *supra*.

146. *See* R. POSNER, *supra* note 1; Bork, *supra* note 5; Bork, *supra* note 66; Posner, *supra* note 109; Preston, *supra* note 66; Williamson, *Market Restrictions*, *supra* note 9.

147. *See, e.g.*, Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J. L. & ECON. 223, 231-32 (1978).

148. Interestingly, this notion of providing extra-contractual protection from termination appears in a number of other long-term relationships. Protection has been forthcoming in the insurance and employment contexts, as well as others. The relatively recent concern for franchisees is, therefore, hardly an aberration.