ANTITRUST REMEDIES FOR FISSURED WORK

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Can parties control independent trading partners through contract? Antitrust law in the United States has confronted this question since its inception. From the 1940s through the 1970s, the Supreme Court generally held that corporations could not control the business decisions of distributors and suppliers using contracts, or vertical restraints in the parlance of antitrust. For example, a manufacturer could not restrict the pricing freedom of distributors by including a minimum or maximum resale price term in sales contracts. Although the courts were somewhat more tolerant of vertical restraints governing non-price terms of trading, they also restricted powerful firms from preventing trading partners from carrying the products of rivals or limiting which territories or customers they could serve. The courts reasoned that vertical restraints offended antitrust norms on two distinct grounds: they unfairly limited the freedom of small and medium-sized firms and unduly restricted business rivalry at one or more levels of a supply chain.

Since the 1970s, the Supreme Court has relaxed antitrust rules on vertical restraints. Firms now have broad freedom to control trading partners, whether distributors, franchisees, or suppliers, through contract and dictate what they sell, where, and on what terms. The result has been a tightening of corporate control and a reduced role for independent business. Vertical restraints common in franchising minutely dictate the management practices of the businesses subject to them. For example, a typical franchise contract not only incorporates a lengthy and detailed operations manual into the contract, but also gives the franchisor the right to unilaterally change it. Franchisors and other lead firms obtain employment-like control over those outside their boundaries, while disowning the duties and responsibilities of employers. David Weil, an economist and former head of the Wage and Hour Division of the Department of Labor, has labeled these arrangements "fissured work."

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The freedom of contract and efficiency justifications for these contracts rest on questionable assumptions and fail to recognize the availability of less restrictive alternatives.

Employing its broad unfair methods of competition power, the Federal Trade Commission should prohibit or limit the use of a range of vertical restraints. In certain instances, work law and franchise relationship law are more appropriate tools for addressing workplace fissuring. Antitrust, working in tandem with these other bodies of law, can work to build a fair economy and promote genuine entrepreneurial independence for countless small and medium-sized firms.

INTRODUCTION

Can parties control independent trading partners through contract? Antitrust law in the United States has confronted this question since its early years.[1] From the 1940s through the 1970s, the Supreme Court generally held that corporations could not control the business decisions of independent distributors and suppliers using contracts, or vertical restraints in the parlance of antitrust. For example, a manufacturer could not restrict the pricing freedom of distributors by including a minimum or maximum resale price term in sales contracts. Although the courts were somewhat

1 Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), *overruled by* Leegin Creative Leather Prod., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

more tolerant of vertical restraints governing non-price terms of trading, they also restricted powerful firms from preventing trading partners from carrying the products of rivals or limiting which territories or customers they could serve. The courts reasoned vertical restraints offended antitrust norms on two distinct grounds: they unfairly limited the freedom of small and medium-sized firms and unduly restricted business rivalry at one or more levels of a supply chain.

In Congress, state legislatures, and the courts, franchisors in fast food and oil refining waged a counterattack in the 1960s to loosen postwar antitrust restrictions on vertical restraints. They argued that vertical restraints created space for small upstream firms to secure distribution and engage in an inexpensive form of vertical integration through contract. Opponents of postwar antitrust rules argued that vertical restraints allowed firms to enter downstream markets without investing large amounts of capital, relying instead on a network of nominally independent distributors and franchisees. Further, they argued that franchising models allowed Americans to pursue entrepreneurial opportunities and independent business ownership while enjoying the advantages of marketing established brands such as McDonald's and Mobil Oil.

Importantly, for franchisors, control through vertical restraints offered them a way to maintain employment-like control while opting out of New Deal employment laws. Notwithstanding the promise of entrepreneurialism, franchisees typically had little autonomy in practice. For instance, in a 1967 report, the Federal Trade Commission wrote, "[T]he retail dealer's position is largely that of an economic serf rather than that of an independent businessman," who "has been coerced into making decisions concerning price and product that are other than his own."[2] By using vertical restraints as a substitute for vertical integration, franchisors created two related loopholes in the interstices between antitrust and labor law. In the first, franchisors used vertical restraints to misclassify franchisees as independent contractors rather than employees, gaining employment-like control over workers without assuming the legal duties and responsibilities under labor and employment law. In the second, franchisors used vertical restraints to gain employment-like control over the employees of their

[2] FED. TRADE COMM'N, REPORT ON ANTICOMPETITIVE PRACTICES IN THE MARKETING OF GASOLINE 42 (1967) [hereinafter FTC GASOLINE REPORT].

independent franchisees, while similarly avoiding incurring legal duties and responsibilities to those workers under joint employment doctrines. Both strategies created "fissured workplaces"[3] in which the firm that actually controlled wages and working conditions was not the legally responsible employer of the workers.

Coming to the aid of franchisors, the Supreme Court initiated a revolution in the law of vertical restraints in a 1977 decision. In *Continental T.V. Inc. v. GTE Sylvania Inc.*, the Court ruled that non-price vertical restraints, in general, should be evaluated under the rule of reason, rather than condemned as per se illegal.[4] Rejecting traditional concerns about dealer freedom, the high court reasoned that vertical restraints, such as territorial limitations, could promote the provision of dealer services by protecting full-service distributors from the "free riding" of no-frills rivals. *Sylvania* was the first in a series of rulings that remade antitrust law on vertical restraints. In subsequent decisions, the Court loosened the per se rule on vertical price fixing and overturned the 95-year-old prohibition on resale price maintenance in 2007. Vertical restraints are now subject to the rule of reason, which in practice amounts to a rule of effective legality. The Supreme Court broadly legalized vertical restraints by relying on questionable assumptions of freedom of contract and theories of economic efficiency.[5]

The result has been a tightening of corporate control and a reduced role for independent business. Vertical restraints are common in both of the two types of franchising: product distribution franchising, and business format franchising. In product distribution franchising (common in the gasoline and auto manufacturing industries), an upstream manufacturer distributes physical goods through a downstream distributor. In business format franchising, the archetypical example of which is fast food, there is no supplier-distributor relationship. Rather, the franchisor sells the franchisee a complete package or "business format," consisting of a license to use the franchisor's branded trademark and detailed

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3 DAVID WEIL, THE FISSURED WORKPLACE: WHY WORK BECAME SO BAD FOR SO MANY (2014).

4 Cont'l T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

5 John Kwoka & Margaret Slade, *Second Thoughts on Double Marginalization*, 34 ANTITRUST 51 (2020), https://econ2017.sites.olt.ubc.ca/files/2020/09/SecondThoughtsOnDoubleMarginalization_Sep2020.pdf [https://perma.cc/6YNH-6RWR]; John Asker & Heski Bar-Isaac, *Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals*, 104 AM. ECON. REV. 672 (2014).

instructions on how to operate it as part of a uniform branded chain. In exchange for the trademark license, the franchisee agrees to be bound by vertical restraints dictating how it must run its business in conformity with brand standards.

Vertical restraints common in both types of franchising minutely dictate the management practices of the businesses subject to them. A typical franchise contract not only incorporates a lengthy and detailed operations manual into the contract, but also gives the franchisor the right to unilaterally change it. The use of vertical restraints to create vertically dis-integrated corporate structures but functionally integrated business organizations was pioneered in gasoline and fast food franchising, but vertical restraints are not limited to franchise contracts. In the poultry industry, vertical restraints imposed by processors (or "integrators") on farmers include supply restrictions, exclusive dealing clauses, detailed prescriptions regarding lighting, heating, ventilation, cooling, and even mandatory instructions on where and how to walk through the chicken house.[6] Meanwhile, e-commerce firm Amazon contracts out last mile package delivery to independent trucking companies it calls "delivery service partners," on whom Amazon imposes contract terms governing routes, prices, the unionization status of employees, and even the fingernail grooming habits of delivery drivers.[7] Finally, "gig economy" companies like Uber and Lyft use vertical restraints to control drivers they misclassify as independent contractors, prescribing fares and driver pay.[8]

Employing its broad "unfair methods of competition"[9] authority, the Federal Trade Commission should prohibit or limit the use of a range of vertical restraints. The Supreme Court stated that the FTC Act "encompass[es] not only practices that violate the Sherman Act and the other antitrust laws, . . . but also practices that the Commission determines are against public policy for other reasons."[10] Non-compete

6 SMALL BUS. ADMIN., EVALUATION OF SBA 7(A) LOANS MADE TO POULTRY FARMERS 7 (2018), https://www.sba.gov/document/report-18-13-evaluation-sbas-7a-loans-poultry-farmers [https://perma.cc/B68B-KNPE].

7 Josh Eidelson & Matt Day, *Amazon Work Rules Govern Tweets, Body Odor of Contract Drivers*, BLOOMBERG LAW (May 5, 2021), https://news.bloomberglaw.com/esg/amazon-work-rules-govern-tweets-body-odor-of-contract-drivers?context=search&index=2 [https://perma.cc/9XR4-LAM2].

8 Marshall Steinbaum, *Antitrust, the Gig Economy, and Labor Market Power: Work after the End of Employment*, 82 L. & CONTEMP. PROBS. 45, 54 (2019).

9 15 U.S.C. § 45 (2018).

10 F.T.C. v. Indiana Fed'n of Dentists, 476 U.S. 447, 454 (1986).

and no-poach clauses that restrict labor mobility and mandatory hours of operation should be per se illegal. These unfair methods of competition severely restrict the autonomy of business owners and are fundamentally inconsistent with independent business ownership. Other restraints do not always have such coercive effects. While price and territory restraints are generally coercive methods and are contrary to the independent status of business owners, upstream firms, in some cases, may have a legitimate interest in requiring trading partners to honor manufacturer prices and territory allocations to facilitate entry into new markets or protect brand names. Still other restraints—certain exclusionary contracts and tying—are typically only harmful when imposed by dominant firms. In those cases, trading partners do not have sufficient available alternatives to decline demands of exclusivity or tied goods or services. To be sure, FTC action does not offer a complete fix for the fissuring problem. Instead FTC policymaking should complement and reinforce reforms to labor, employment, and franchise laws.

I
ANTITRUST RESTRICTIONS ON CONTROL THROUGH CONTRACT IN THE POSTWAR ERA

In the postwar era, the Supreme Court restricted corporations' ability to control trading partners, such as distributors and franchisees, using vertical restraints. The Court affirmed and broadened existing prohibitions on vertical price restraints and adopted new limits on non-price restraints. The Court's rationale was that these vertical restraints deprived independent firms of autonomy, restricted price competition, and impeded the entry of new firms. Even as the courts limited the use of vertical restraints, business interests, notably franchisors in fast food and oil refining, were fighting to overturn these rules and establish business models in which they exercised control through contract.

A. The Courts Restrict Control Through Contract

In the postwar era, the federal judiciary imposed major legal restrictions on vertical restraints.[11] Corporations had limited ability to control distributors and other trading

11 Even as the courts limited the use of vertical restraints, they were much more hostile toward horizontal restraints, i.e., agreements among competitors, than toward vertical restraints. *See, e.g.*, United States v. Sealy, Inc., 388 U.S. 350, 354 (1967); United States v. Topco Associates, Inc., 405 U.S. 596, 608 (1972).

partners through contract. If they wanted to exercise such control, they had to vertically integrate through corporate ownership and make the workers at the vertical affiliate employees. The Supreme Court and courts of appeals restricted control through contract, because it limited the autonomy of independent business proprietors, reduced price competition among retailers and distributors, and excluded rivals.

In this period, the Supreme Court affirmed and broadened the per se rule on resale price restraints. The prohibition on resale price maintenance was originally announced in a 1911 decision.[12] In the postwar era, the Court upheld the per se rule and limited the scope of state fair trade laws that permitted resale price maintenance in intrastate commerce.[13] Although the Court had permitted manufacturers to unilaterally announce minimum resale prices in *United States v. Colgate & Co.*,[14] this doctrine was read narrowly. Even in the absence of contractual agreements on resale prices, the Court held that the *Colgate* doctrine did not apply "[w]hen the manufacturer's actions, as here, go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adhere to his resale prices."[15] Building on the rule against minimum resale price maintenance, the Court prohibited *all* forms of vertical price fixing when it ruled vertical restraints that imposed a maximum resale price were also per se illegal.[16]

The Supreme Court placed limits on corporations' use of contract to control what trading partners could sell and where. In *Standard Oil Co. v. United States*, the Court, applying the Clayton Act, invalidated contracts between Standard Oil and gas stations that restricted the stations from purchasing and reselling the fuel of Standard Oil's rivals.[17] In a subsequent decision, the Court held that exclusive arrangements between Brown Shoe, the second largest shoe manufacturer in the United States at the time, and hundreds

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12 Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), *overruled by* Leegin Creative Leather Prod., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

13 United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 724 (1944).

14 250 U.S. 300 (1919).

15 United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960)

16 Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951), *overruled by* Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752 (1984); Albrecht v. Herald Co., 390 U.S. 145 (1968), *overruled by* State Oil Co. v. Khan, 522 U.S. 3 (1997).

17 337 U.S. 293, 314 (1949).

of shoe stores was an unfair method of competition that violated the FTC Act.[18] In a trio of decisions, the federal courts held that three major oil companies violated the FTC Act when they coaxed gas stations into carrying only favored brands of tires, batteries, and accessories.[19]

After expressing reluctance to condemn territorial restraints categorically in a 1963 decision,[20] the Court adopted a per se prohibition in its 1967 case called *United States v. Arnold, Schwinn & Co.*[21] In that decision, it adopted a bifurcated rule on vertical restraints limiting where a distributor can sell products. First, it held that, when title passes to the distributor, territorial restraints on distributors are per se illegal.[22] Second, it ruled that, in consignment arrangements in which manufacturers retained title after physical transfer to a distributor, territorial restraints are subject to the rule of reason.[23] The rule of reason is a fact-intensive inquiry in which generally the plaintiff must show adverse effects from a challenged practice.[24]

The protection of business autonomy was a major theme in the vertical restraint cases of the era. The courts sought to uphold the right of independent businesses to exercise effective independence.[25] They recognized the inequality in common business relationships between distributors and

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18 F.T.C. v. Brown Shoe Co., 384 U.S. 316, 320-22 (1966).

19 F.T.C. v. Texaco, Inc., 393 U.S. 223 (1968); Atl. Ref. Co. v. F.T.C., 381 U.S. 357 (1965); Shell Oil Co. v. F.T.C., 360 F.2d 470 (5th Cir. 1966).

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

21 388 U.S. 365 (1967), *overruled by Sylvania*, 433 U.S. 36 (1977).

22 *Id.* at 382.

23 *Id.* at 381-82.

24 For an early articulation of the rule of reason in antitrust law, see *Board of Trade of City of Chicago v. United States*, 246 U.S. 231, 238 (1918) (Brandeis, J.) ("[T]he true test of legality is whether the restraint [imposed] is such as merely regulates, and perhaps thereby promotes, competition, or whether it is such as may suppress or even destroy competition. To determine [that] question, the court must ordinarily consider the facts peculiar to the business . . . [to which the] restraint [is applied]; its condition before and after the restraint was imposed, the nature of the restraint, and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts."); For a recent description of the rule of reason framework, see *United States v. Microsoft Corp.*, 253 F.3d 34, 58-59 (D.C. Cir. 2001) (en banc) (articulating a four-part test for establishing illegal monopolization).

25 *See, e.g.*, Simpson v. Union Oil Co. of Cal., 377 U.S. 13, 16 (1964) ("If the 'consignment' agreement achieves resale price maintenance in violation of the Sherman Act, it and the lease are being used to injure interstate commerce by depriving independent dealers of the exercise of free judgment whether to become consignees at all, or remain consignees, and, in any event, to sell at competitive prices.").

manufacturers,[26] gas station owners and oil companies,[27] and newspaper distributors and publishers,[28] and the potential for economic coercion and domination. Capturing the inequality at the core of many economic arrangements, the Fifth Circuit, in one of the tires, batteries, and accessories (TBA) cases, wrote, "A man operating a gas station is bound to be overawed by the great corporation that is his supplier, his banker, and his landlord."[29]

Accordingly, courts during the era viewed vertical restraints as instruments of domination. The Supreme Court condemned vertical price restraints for "crippl[ing] the freedom of traders."[30] In a 1964 decision, the Court described resale price maintenance contracts as depriving gas station owners of "the only power they have to be wholly independent businessmen, whose service depends on their own initiative and enterprise."[31] The absence of pricing freedom could be a question of survival for a business, because discounting was an important way for "small struggling competitors" to draw customers away from rivals not hobbled by similar restraints.[32]

In a similar spirit, the courts condemned restrictions on what distributors could sell for depriving independent businesses of freedom of choice as purchasers. The Supreme Court stated that an exclusive dealing arrangement "conflict[ed] with the [central] policy of both § 1 of the Sherman Act and § 3 of the Clayton Act against contracts which take away freedom of purchasers to buy in an open market."[33] It warned that permitting such restrictions under antitrust law could give rise to franchise relationships in which one nominally independent business is wholly dependent on another.[34]

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26 United States v. Parke, Davis & Co., 362 U.S. 29, 46 (1960).

27 F.T.C. v. Texaco, Inc., 393 U.S. 223 (1968); Atl. Ref. Co. v. FTC, 381 U.S. 357, 226-27 (1965).

28 Albrecht v. Herald Co., 390 U.S. 145, 153 (1968), *overruled by* State Oil Co. v. Khan, 522 U.S. 3 (1997).

29 Shell Oil Co. v. F.T.C., 360 F.2d 470, 487 (5th Cir. 1966).

30 Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951), *overruled by* Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752 (1984).

31 Simpson v. Union Oil Co. of Cal., 377 U.S. 13, 21 (1964); United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 721 (1944) ("[The manufacturer] sells to its wholesalers at prices satisfactory to itself. Beyond that point it may not project its power over the prices of its wholesale customers by agreement.").

32 *Id.*

33 F.T.C. v. Brown Shoe Co., 384 U.S. 316, 321 (1966).

34 *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379, *overruled by Sylvania*, 433 U.S. 36 (1977). ("To permit [Schwinn's restraints] would sanction franchising and confinement of distribution as the ordinary instead of

The judicial hostility to vertical restraints had other rationales as well. The courts believed that these restraints could foster collusion or achieve collusive ends and that certain non-price restraints could marginalize competitors. These themes were recurring in the judicial opinions of the period.

The courts believed that vertical price restraints improperly limited horizontal price competition. The preservation of "competitive prices" was an animating theme in decisions of the era.[35] Specifically, by establishing price floors on resale, vertical price restraints limited competition among rival retailers and distributors.[36] In one case, the Supreme Court described the manufacturer of medications enforcing a resale price maintenance scheme as "the organizer of a price-maintenance combination" among pharmacies.[37] A similar logic extended to price restraints that established a ceiling on prices. These restraints displaced "the forces of the competitive market"[38] and could function, in practice, as a minimum resale price arrangement.[39]

The courts stressed the exclusionary potential of non-price vertical restraints. This foreclosure concern arose most commonly in cases concerning exclusive dealing and related contracts. Manufacturers could use these contracts to shut rivals out of a substantial segment of the market. In *Standard Oil*, the Court wrote that "observance by a dealer of his requirements contract with Standard does effectively foreclose whatever opportunity there might be for competing suppliers to attract his patronage."[40] The foreclosure threat was heightened because competitors of Standard also required exclusivity from their dealers.[41] The TBA cases also echoed this concern. In *Atlantic Refining v. F.T.C.*, the Supreme Court stated that by compelling retailers to only carry favored tires,

the unusual method which may be permissible in an appropriate and impelling competitive setting, since most merchandise is distributed by means of purchase and sale.").

35 *See Simpson*, 377 U.S. at 16.

36 United States v. Parke, Davis & Co., 362 U.S. 29, 47 (1960); *Simpson*, 377 U.S. at 21.

37 *Parke, Davis & Co.*, 362 U.S. at 47.

38 Albrecht v. Herald Co., 390 U.S. 145, 152 (1968), *overruled by* State Oil Co. v. Khan, 522 U.S. 3 (1997).

39 *Id.* at 153.

40 Standard Oil Co. v. United States, 337 U.S. 293, 314 (1949).

41 *See id.* ("In view of the widespread adoption of such contracts by Standard's competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive.").

batteries, and accessories, Atlantic "effectively sew[ed] up large markets."[42]

B. Looking Beyond the Case Law

The increasingly widespread use of vertical restraints by mass production manufacturing firms alarmed many observers. As the economist Walton Hamilton wrote about resale price maintenance contracts between tobacco corporations and small retailers in 1940: "It presents an industrial order in which overlords, through contract, collect their feudal dues."[43] As the Supreme Court noted in *Schwinn*, franchising as a method of business was "unusual" during the 1960s.[44]

Franchisors argued that courts and legislatures should take a permissive attitude toward their novel use of vertical restraints. They contended that franchising offered an efficient system that preserved a role for independent business in an increasingly corporate economy. In this vision, vertical restraints were the price society had to pay to preserve a role for small business in the face of an economy dominated by large vertically integrated manufacturing firms and corporate retail chains. For small upstream businesses, vertical restraints enabled them to enter markets at a lower cost to compete with large vertically integrated incumbents. Downstream, the franchise system held back the danger of the United States becoming a "nation of clerks," by preserving a role for independent entrepreneurs who otherwise would have been presumably salaried store managers—a lower social status according to prevailing views of self-mastery, independence, and business ownership. According to the then-General Counsel for the International Franchise Association, the main trade association and lobbying group for franchisors and the driving force behind the push to liberalize vertical restraints law:

> [T]he franchising relationship presents the only viable alternative to vertical integration . . . [T]he lesser restraints of the franchise relationship will inevitably be replaced by

42 381 U.S. 357, 371.

43 WALTON HAMILTON, THE PATTERN OF COMPETITION 33 (1940).

44 United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967), *overruled by* Cont'l T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) ("To permit this would sanction franchising and confinement of distribution as the ordinary, instead of the unusual, method which may be permissible in an appropriate and impelling competitive setting, since most merchandise is distributed by means of purchase and sale.").

> the greater restraints of vertical integration if the franchise relationship is frustrated by Federal law.[45]

He warned that if franchisors were prevented from imposing vertical restraints they would be forced to integrate forward, reducing entrepreneurial opportunities. In many cases, the lower courts agreed and found ways to work around Supreme Court precedent. As the District Court stated in *Susser v. Carvel*, "[I]f our economy had not developed [franchising], these individuals would have turned out to have been merely employees."[46]

Franchisees countered that franchisors' overwhelming power and tight control through vertical restraints reduced franchisees to the status of *de facto* employees, but without employee rights to receive overtime pay or form unions. According to Dunkin' Donuts franchisee leader James D. Cerajewski, franchisees were "virtual employee[s]" of the chain, whom vertical restraints made into "captured customer[s]," who were "restrained by Dunkin' Donuts from full use of [their] abilities."[47] Many observers agreed. Jerry S. Cohen, counsel to the Senate Subcommittee on Antitrust and Monopoly, argued:

> One wonders how far you can go in contractual restraints before a so-called independent businessman is no longer an independent businessman, but is so tied down that he is merely an employee of the person he supposedly has a franchise from.[48]

Senator Philip Hart noted that "[t]his 'last frontier' of the independent businessman may prove only [to be] a forlorn

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45 Lewis G. Rudnick, *The Pathology of the Franchise Relationship*, LEGAL BULL. (Int'l Franchise Ass'n, Chi., Ill.), 1967, at 245. Justice William O. Douglas made a similar point in his dissent in *Standard Oil*. He wrote, "[t]he method of doing business under requirements contracts at least keeps the independents alive. They survive as small business units. The situation is not ideal from either their point of view or that of the nation. But the alternative which the Court offers is far worse from the point of view of both. The elimination of these requirements contracts sets the stage for Standard and the other oil companies to build service-station empires of their own." *Standard Oil*, 337 U.S. at 319-20 (Douglas, J., dissenting).

46 Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964).

47 *The Role of Small Business in Franchising: Hearing Before the Subcomm. on Minority Small Bus. Enter. & Franchising of the H.R. Permanent Select Comm. on Small Bus.*, 93rd Cong. 107-15 (1973) (statement of James D. Cerajewski, Franchisee, Dunkin Donuts).

48 *Distribution Problems Affecting Small Business: Hearing Before the Subcomm. on Antitrust & Monopoly of the S. Comm. on the Judiciary*, 89th Cong. 93 (1965) (statement of Jerry S. Cohen, Staff Director and Chief Counsel, Senate Subcommittee on Antitrust and Monopoly).

mirage. . . .[49]"

The danger, according to observers like Hart, was that vertical restraints reduced nominally independent entrepreneurs to the status of de facto employees, but without the protection of labor and employment laws. In other words, the concern was that firms would misclassify workers as independent contractors to deny them employment rights. Franchisors made their claims about franchising as the last hope for small business in the aftermath of the passage of the 1935 National Labor Relations Act, which gave employees collective bargaining rights, and the 1947 Taft-Hartley Act, which restricted those rights and narrowed the number of individuals protected by the law as "employees."

At the heart of the NLRA was a recognition of the power imbalance between employers and employees. The Supreme Court in the 1944 case *NLRB v. Hearst Publications* interpreted the meaning of employee broadly, applying it to independent newspaper distributors. Like franchisees, the distributors did not receive wages in exchange for time, but rather bought newspapers from Hearst and resold them to the public, pocketing the difference as profit. The Court, however, reasoned that because newspaper distributor earnings were highly influenced by Hearst's vertical restraints such as the fixing of buying and selling prices, allocating territories, and controlling the supply of newspapers, the newspaper distributors were in fact employees. This control entitled them to the labor exemption from antitrust law and the right to engage in unionization, collective bargaining, and other concerted action under the NLRA.[50]

A bipartisan conservative majority in Congress repealed the *Hearst* decision in 1947. In the Taft-Hartley Act, Congress expressly deprived independent contractors of collective bargaining rights. Even independent contractors, such as newspaper distributors, dominated and controlled by large firms could not band together to build power.

The Teamsters Union complained to Congress in 1963 that Taft-Hartley gave oil companies "double-barreled immunity" from both antitrust and labor laws. They alleged that oil companies employed the legal trick of classifying franchised dealers as independent contractors, which denied them

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49 *Distribution Problems Affecting Small Business: Hearing Before the Subcomm. on Antitrust & Monopoly of the S. Comm. on the Judiciary*, 89th Cong. 699 (1966) (statement of Senator Hart).

50 N.L.R.B. v. Hearst Publications, 322 U.S. 111 (1944), *overruled in part by* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992).

collective bargaining rights, while at the same time using vertical restraints to reduce dealers to the functional status of employees.[51] The National Congress of Petroleum Dealers told the Senate antitrust subcommittee a few years later that if Congress could not protect dealers from unfair termination and unreasonable vertical restraints, it should give dealers the right to protect themselves through collective bargaining.[52] To dealers, as with gig workers like rideshare drivers decades later, vertical restraints functioned as a kind of "legal arbitrage" that put them outside the protection of the laws that should have protected them.[53]

In response to franchisees organizing (notwithstanding the lack of legal protection for this activity), franchisors often retaliated with classic union-busting tactics, including threats and retaliation against "troublemakers." During the 1970s, for example, McDonald's franchisees accused the company of threatening not to renew the contracts of franchisees who joined the franchisee association.[54] Meanwhile, in what would likely have amounted to "hallmark" violations of the NLRA if franchisees were under its protection (as well as violations of laws against making threats of physical violence), Dunkin' Donuts CEO Bob Rosenberg personally threatened to "kill every one of you" joining the franchisee association.[55] Dunkin' Donuts also launched retaliatory inspections of the stores of franchisees who joined the association, and the North Carolina Attorney General accused the company of evicting several franchisees for complaining to its office about the retaliation.[56]

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51 *The Impact Upon Small Business of Dual Distribution and Related Vertical Integration: Hearings Before Subcomm. No. 4 of the H. Select Comm. on Small Business,* 88th Cong. 771 (1963) (statement of Sidney Zagari, Legislative Counsel, International Brotherhood of Teamsters, Washington, DC).

52 *Distribution Problems Affecting Small Business: Hearing Before the Subcomm. on Antitrust & Monopoly of the S. Comm. on the Judiciary*, 89th Cong. 571 (1966) (statement of Wiliam D. Snow, Executive Secretary and General Counsel, National Congress of Petroleum Retailers, Toledo, Ohio).

53 Julia Tomasetti, *Does Uber Redefine the Firm? The Postindustrial Corporation and Advanced Information Technology*, 34 HOFSTRA LAB. & EMP. L.J. 1 (2016); Ruth Berins Collier, V.B. Dubal, & Christopher L. Carter, *Disrupting Regulation, Regulating Disruption: The Politics of Uber in the United States*, 16 PERSP. ON POL. 919 (2018).

54 *Fairness in Franchising Act: Hearing Before the S. Commerce Comm.,* 94th Cong. 385-386 (1976).

55 "Hallmark" violations of the NLRA, the most serious types of Unfair Labor Practices, include threats of plant closure and termination, and are especially egregious when delivered personally by the CEO. *See* N. L. R. B. v. Gissel Packing Co., 395 U.S. 575 (1969).

56 *See supra* note 47, at 115-16 (1973) (statement of James D. Cerajewski, Franchisee, Dunkin Donuts).

Unlike statutory employees protected by the NLRA, however, franchisees had little legal recourse against these actions, as collective action like strikes or boycotts against their franchisors were illegal under the antitrust laws.[57]

The Federal Trade Commission undertook studies of vertical restraints and franchising during this period. In a 1967 report on the gasoline industry, the FTC declared:

> The importance of the small retailer in our economy is difficult to overstate. In the gasoline industry, he is the competitive entity that bears the greatest proportionate risk and earns the lowest return on investment. As a small businessman, an individual entrepreneur, his welfare is of particular concern to this Commission. Interference with his right to compete as he chooses and unlawful practices that blunt the effects of his efforts and tend to cause his elimination are matters calling for public intervention.[58]

The FTC continued that "the retail dealer's position is largely that of an economic serf rather than that of an independent businessman," who "has been coerced into making decisions concerning price and product that are other than his own."[59] The FTC acknowledged that oil company resale price maintenance tended to require *lower* prices. Even from a consumerist perspective, it argued that, in the long run, preserving a market free from vertical restraints at the retail level would ultimately result in better prices and quality for consumers. "The Commission," the report further concluded, "is unimpressed by any industry argument that employment of coercion is beneficial because it results in lower price."[60] In another report released the same year, however, the Commission adopted a softer tone toward vertical restraints in business format franchises, citing the business format franchisor's interest under the Lanham Act in protecting the value of its trademark.[61]

Nonetheless, the FTC continued to keep an eye on franchising throughout the 1970s. It initiated a broad

57 McAlpine v. AAMCO Automatic Transmissions, Inc., 461 F. Supp. 1232 (E.D. Mich. 1978). *See also* Columbia River Packers Ass'n v. Hinton, 315 U.S. 143, 146 (1942) (holding that collective bargaining by fishers is not protected by antitrust law's labor exemption because "their desire is to continue to operate as independent businessmen, free from such controls as an employer might exercise").

58 FTC GASOLINE REPORT, *supra* note 2, at 40.

59 *Id.* at 42.

60 *Id.*

61 FED. TRADE COMM'N, REPORT OF THE AD HOC COMMITTEE ON FRANCHISING (1967).

investigation into fast food franchisors' purchase restrictions in 1975.[62] In its 1978 budget request to Congress, the FTC requested $1.35 million for investigations into vertical restraints investigations that "place[d] small businesses at a competitive disadvantage."[63]

II
THE SUPREME COURT GRANTS POWERFUL FIRMS THE RIGHT TO CONTROL TRADING PARTNERS THROUGH CONTRACT

Beginning in 1977, the Supreme Court initiated a fundamental remaking of antitrust rules concerning vertical restraints.[64] The Court that year relaxed antitrust restrictions on non-price vertical restraints and subsequently liberalized rules on price restraints. In revising the rules on vertical restraints, the high court abandoned concerns with distributors' freedom and focused principally on the efficient distribution of goods. Embracing the view that "Congress designed the Sherman Act as a 'consumer welfare prescription,'"[65] the Court elevated the high output it believed would result from interbrand competition over the freedoms of independent merchants to control their own businesses. This reconstruction of the law permitted powerful corporations to control distributors and other trading partners through contract.

In *Continental T.V. Inc. v. GTE Sylvania Inc.*, the Court held that territorial and other non-price restraints would, in general, no longer be subject to the per se rule.[66] It reasoned that the bifurcated rule on these restraints announced in *Schwinn* was untenable. It held that the per se rule should apply to all territorial restraints or to none of them and dismissed the transfer of title as an irrelevant concern under the antitrust laws.[67] The Court opted to abandon the per se

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62 FED. TRADE COMM'N, ANNUAL REPORT 12 (1975), https://www.ftc.gov/sites/default/files/documents/reports_annual/annual-report-1975/ar1975_0.pdf [https://perma.cc/84TK-CSZW].

63 *Departments of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriation for 1978: Hearing Before the Subcomm. of the H.R. Comm. on Appropriations*, 95th Cong. 30 (1977).

64 Even before 1977, some lower courts were beginning to chip away at postwar antitrust rules on vertical restraints. For example, they distinguished the facts before them from the facts in Supreme Court cases and declined to apply per se rules. *See, e.g.*, Goldinger v. Boron Oil Co., 375 F. Supp. 400, 404-5 (W.D. Pa. 1974), *aff'd*, 511 F.2d 1393 (3d Cir. 1975).

65 Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979) (citing ROBERT BORK, THE ANTITRUST PARADOX 66 (1978)).

66 433 U.S. 36 (1977).

67 *Id.* at 57.

rule and held that all territorial restraints in a vertical relationship should be subject to the rule of reason.[68] Even as the Court stated "we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition. . . ,"[69] it established the rule of reason as the default for all non-price vertical restraints.[70]

The Court subsequently held that vertical price restraints should also be evaluated under the rule of reason. In *State Oil Co. v. Khan*, it overturned the per se rule for maximum vertical price fixing and ruled these contracts are subject to the rule of reason.[71] In *Leegin Creative Leathers Products, Inc. v. PSKS, Inc.*, the rule of reason was extended to minimum vertical price fixing or resale price maintenance.[72] Between the announcement of *Sylvania* in 1977 and *Leegin* in 2007, the Court had eroded the effectiveness of the per se rule against resale price maintenance by imposing additional burdens on plaintiffs challenging these restraints.[73]

In remaking the law of vertical restraints, the Court adopted a new set of antitrust aims. The Court held that antitrust law should protect the efficient distribution of goods and competition among brands rather than among distributors over the same brand.[74] In the *Sylvania* and *Leegin* decisions, the threat of free riding by discount retailers was the principal animating concern. Specifically, the Court believed that, in the absence of these restraints, discounters could free ride on services offered by rival retailers. By way of example, consumers could learn about a product through demonstrations and conversations with sales staff at a full-service retailer and purchase it for a lower price at a no-frills competitor.[75] This free riding would discourage the provision of retail services.[76] It is far from clear whether any of

68 *Id.* at 57-58.

69 *Id.* at 58.

70 *Id.* at 59.

71 522 U.S. 3 (1997).

72 551 U.S. 877 (2007).

73 Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984); Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988).

74 *Sylvania*, 433 U.S. at 54-55. *See also id.* at 52 n.19 ("Interbrand competition is the competition among the manufacturers of the same generic product—television sets in this case—and is the primary concern of antitrust law.").

75 *Id.* at 55, 65; *Leegin*, 551 U.S. at 890-91.

76 *Sylvania*, 433 U.S. at 55; *Leegin*, 551 U.S. at 890-91. *See also Business Elecs.*, 485 U.S. at 731 ("Petitioner has provided no support for the proposition that vertical price agreements generally underlie agreements to terminate a price cutter. That proposition is simply incompatible with the conclusion of *GTE*

the vertical restraints cases the Court decided after 1977 involved actual or probable threats of free riding,[77] or whether free riding by discounters is a common threat in the real world.[78]

The Court also believed that distributional restraints could facilitate new entry. By limiting competition at the retail level and ensuring sufficient margins, new manufacturers could entice retailers to carry their goods and obtain market share. Without this carrot of attractive margins, these entrants might not be able to secure retail shelf space and a commitment from retailers to promote their products. This objective was most directly addressed in *Leegin*. The Court wrote, "[n]ew products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a procompetitive effect."[79]

In revising vertical restraints law, the Supreme Court abandoned the traditional concern with the autonomy of businesses. Judge White noted this historical aim of antitrust law in his concurrence in *Sylvania*. He called out the majority for discarding this purpose and adopting a new one out of whole cloth.

> [W]hile according some weight to the businessman's interest in controlling the terms on which he trades in his own goods may be anathema to those who view the Sherman Act as directed solely to economic efficiency, this principle is without question more deeply embedded in our cases than the notions of "free rider" effects and distributional efficiencies borrowed by the majority from the "new economics of vertical relationships."[80]

But after White's concurrence, this theme largely disappeared from Supreme Court jurisprudence on vertical restraints. The *Leegin* Court noted—and dismissed—the common law concern

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Sylvania and *Monsanto* that manufacturers are often motivated by a legitimate desire to have dealers provide services, combined with the reality that price cutting is frequently made possible by 'free riding' on the services provided by other dealers.").

77 For instance, in *Business Elecs.*, Justice Stevens, in dissent, wrote, "In sum, this simply is not a case in which procompetitive vertical nonprice restraints have been imposed; in fact, it is not a case in which any procompetitive agreement is at issue. The sole purpose of the agreement between respondent and Hartwell was to eliminate price competition at [the retail] level." 485 U.S. 757-58 (Stevens, J., dissenting).

78 Marina Lao, *Free Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance*, *in* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 196 (Robert Pitofsky, ed., 2008).

79 *Leegin*, 551 U.S. at 891.

80 *Sylvania*, 433 U.S. at 68-69 (White, J., dissenting).

with "restraints on alienation,"[81] while dissents in *Leegin* and *Business Electronics* challenged the majority's reasoning solely on distributional efficiency and consumer welfare grounds.[82]

In the *Sylvania* line of cases, the Supreme Court granted powerful firms the right to control trading partners. Whereas many forms of vertical integration previously required corporate ownership, the new rules permitted extensive vertical integration through contracts.[83] For example, manufacturers could dictate prices (the minimum resale price of the product) and non-price terms (the locations from which the business could sell the manufacturer's product) to distributors and be certain they would be evaluated under the rule of reason. In practice, the rule of reason, with its stringent requirements on showing market power and adverse consumer effects, functioned as a rule of "de facto legality."[84]

III
THE DESPOTISM OF FISSURED ARRANGEMENTS

The welfare argument for vertical restraints depends on a strong freedom of contract assumption. According to this story, parties agreed to the contract, because they believed it would make them better off. The state should not interfere with the will of the parties. If a court refuses to enforce the terms of the contract or modifies them, the state is overriding the informed judgment of the parties and substituting its preferences for the preferences of the contracting parties.

This freedom of contract assumption ignores disparities in power in the real world. In contexts like franchising, the gig economy, or poultry farming, vertical restraints are typically

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81 *See Leegin*, 551 U.S. at 888 ("The general restraint on alienation, especially in the age when then-Justice Hughes used the term, tended to evoke policy concerns extraneous to the question that controls here. Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations. The Court should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance.").

82 *Leegin*, 551 U.S. at 908-29 (Breyer, J., dissenting); *Business Electronics*, 485 U.S. at 736-58 (Stevens, J., dissenting).

83 *See, e.g.*, Marion Healthcare, LLC v. Becton Dickinson & Co., 952 F.3d 832, 838-39 (7th Cir. 2020) ("Vertical integration can occur either by internalizing functions within one firm . . . or by contract.").

84 Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991). *See also* Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 837 (2009) ("In the first decade of the twenty-first century, courts have continued their use of a burden-shifting framework in applying the rule of reason. They almost never balance. And they dispose of 97% of rule of reason cases on the grounds that the plaintiff cannot show an anticompetitive effect.").

not negotiated but rather imposed by the more powerful party in take-it-or-leave-it contracts.[85] The background inequality between the parties is compounded when the franchisees are recent immigrants with limited means and command of English and the franchisers are multinational corporations.[86] Furthermore, a number of common vertical restraints in franchise contracts artificially depress the value of the franchisee's outside option should they exit the contract, locking them into unfair contracts and giving franchisors the ability to impose high costs on franchisees by terminating the contract. These include choice of forum, non-compete, right-of-first-refusal, individual and spousal guarantees, mandatory arbitration clauses, and the right to force franchisees to make non-recoverable sunk capital investments.[87]

Cognitive biases that are now well-known to economists exacerbate the baseline inequality of bargaining power between franchisors and franchisees, poultry integrators and farmers, and gig platforms and workers. Even if franchisees and dealers who sign take-it-or-leave-it contracts fully understand each vertical restraint clause in take-it-or-leave-it contracts, real-life economic agents exhibit cognitive biases that call into question the welfare-enhancing claims about vertical restraints. For example, loss-aversion due to endowment effects means that from any point in time, agents weigh prospective losses more heavily than gains.[88] Studies have found evidence of loss aversion in the possession of everything from coffee mugs to the number of pizza toppings considerably less significant investments than those entailed by a long-term franchise contract.[89] Moreover, the endowment effects are adaptive,

85 For an analysis of why this inequality exists in many standard economic relationships, *see generally* Sandeep Vaheesan & Matthew Jinoo Buck, *Non-Competes and Other Contracts of Dispossession*, 2022 MICH. ST. L. REV. 113.

86 Tiffany Hsu & Rachel Abrams, *Subway Got Too Big. Franchisees Paid a Price.*, N.Y. TIMES (June 28, 2019), https://www.nytimes.com/2019/06/28/business/subway-franchisees.html [https://perma.cc/78MV-WS3L].

87 Brian Callaci, *What Do Franchisees Do? Vertical Restraints as Workplace Fissuring and Labor Discipline Devices*, 1 J.L. & POL. ECON. 397 (2021).

88 Shlomo Benartzi & Richard H. Thaler, *Myopic Loss Aversion and the Equity Premium Puzzle*, 110 Q.J. ECON. 73 (1995); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979); Nathan Novemsky & Daniel Kahneman, *The Boundaries of Loss Aversion*, 42 J. MARKETING RES. 119 (2005); Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39 (1980); Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q.J. ECON. 1039 (1991).

89 Ziv Carmon & Dan Ariely, *Focusing on the Foregone: How Value Can*

meaning valuation of a good like a franchise license increases with the duration of the contract.[90] In other words, once a franchisee or dealer starts making sunk investments in their business, they overweight the costs of losing them, and that overweighting increases over time. Inequality in bargaining power favors the franchisor throughout the duration of the contract: the franchisee a few years into a contract is in effect a different, and more "stuck," franchisee from the one that initially signed it.

Apart from relying on freedom of contract assumptions, defenders of vertical restraints argue that they increase efficiency in two senses: in the neoclassical economics sense of improving welfare and in the technical sense of maximizing output. The basic logic underlying the welfare argument for vertical restraints is summarized by Lafontaine and Slade, who argue: "Since [vertical restraints] restrict the actions of one or both parties, there must be offsetting benefits. Otherwise parties would not voluntarily enter into agreements that limit their flexibility."[91] The welfare claim needs to be qualified in two respects. First, unequal bargaining power and realities of human cognition discussed above mean that even "voluntary" contracts do not inevitably make both parties better off. Second, the contracts affect third parties who did not even formally assent to their terms: vertical restraints affect the well-being of workers employed at downstream firms, who have no say in such contracts under current law.

Vertical restraints constrain the labor management strategies available to firms subject to them, affecting workers who are not party to the original contract. For example, no-poaching agreements common in many franchised agreements create monopsonies, depressing the wages of

Appear So Different to Buyers and Sellers, 27 J. CONSUMER RES. 360 (2000); Daniel Kahneman, Jack L. Knetsch, & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990); Irwin P. Levin, Judy Schreiber, Marco Lauriola, & Gary J. Gaeth, *A Tale of Two Pizzas: Building Up from a Basic Product Versus Scaling Down from a Fully-Loaded Product*, 13 MARKETING LETTERS 335 (2002); Sankar Sen & Eric J. Johnson, *Mere-Possession Effects Without Possession in Consumer Choice*, 24 J. CONSUMER RES. 105 (1997).

90 Stephen J. Hoch & George F. Loewenstein, *Time-Inconsistent Preferences and Consumer Self-Control*, 17 J. CONSUMER RES. 492 (1991); Michal A. Strahilevitz & George Loewenstein, *The Effect of Ownership History on the Valuation of Objects*, 25 J. CONSUMER RES. 276 (1998).

91 Francine Lafontaine & Margaret E. Slade, *Inter-Firm Contracts: Evidence, in* THE HANDBOOK OF INDUSTRIAL ORGANIZATION ECONOMICS 958 (Robert Gibbons and John Roberts, eds., 2012).

workers at franchised establishments.[92] Restraints like resale price maintenance, mandatory hours of operation, and supplier restrictions take variables out of the franchisee's profit-maximizing choice set, forcing them into minimizing labor costs and extracting labor effort for their profit margins.[93] After one McDonald's franchisee complained about the effect of resale price maintenance on her profits, McDonald's responded by telling her to "just pay your employees less."[94] Workers may not even be aware of these vertical restraints, let alone a party to them, yet they are harmed by them.

Turning to the output maximization version of efficiency, vertical restraints can *theoretically* increase output in several ways, which all fall under the broad category of reducing agency costs and aligning the incentives of the party subject to a restriction with the interests of the party imposing it. Maximum vertical price restraints can eliminate the double marginalization (or double markup) problem.[95] Minimum vertical price restraints and exclusive territories should, in theory, induce dealers to provide services.[96] Exclusive dealing contracts with distributors can protect manufacturers from dealer free riding, encouraging profitable investments by the manufacturer that would not otherwise be made. For example, an athletic shoe company might be deterred from investing in expensive technology that tailored running shoes to a customer's foot size and running stride if retail franchisees were allowed to use the technology to sell competing brands of shoes.

More generally, because franchisees have incentives to free ride on both the value of the franchisor's brand and on the efforts of other franchisees, vertical restraints can internalize these externalities and compel higher franchisee effort levels

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92 Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise Sector* (Nat'l Bureau of Econ. Research, Working Paper No. w24831).

93 Callaci, *supra* note 87.

94 Lydia DePillis, *McDonald's Franchisee Says the Company Told Her "Just Pay Your Employees Less*," WASH. POST (Aug. 4, 2014), https://www.washingtonpost.com/news/storyline/wp/2014/08/04/first-person-kathryn-slater-carter-the-franchise-owner-taking-on-mcdonalds/ [https://perma.cc/BA5C-3QMY].

95 Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. POL. ECON. 347 (1950); Andrea Shepard, *Contractual Form, Retail Price, and Asset Characteristics in Gasoline Retailing*, 24 RAND J. ECON. 58 (1993).

96 Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

and compliance with franchisor policies.[97] Meta-analyses of the effects of vertical restraints find that vertical restraints imposed on dealers and franchisees tend to be associated with higher output, lower costs, higher stock market returns, and more upstream firm survival, with little evidence of foreclosure.[98] Many economists interpret these results as evidence of efficiency, although the results could be due to factors other than the elimination of free-riding proposed in the theoretical models. However, elimination of double marginalization creates efficiencies only in specific circumstances, namely, a manufacturer-distributor relationship with successive monopolies at both levels and a fixed-proportion production process. Not only is this a special case in production distribution franchising, it does not apply at all to business format franchising, where there is no manufacturer-distributor relationship.[99]

In addition, the efficiency gains and consumer benefits from vertical restraints where the upstream firm shares profits with the retailer to induce improved service and sales effort are not realized in all possible circumstances. On the contrary, they depend on the retailer not accommodating downstream entry, or distributing for other upstream firms. The benefits relative to the counterfactual where upstream firms are competing downstream without restraints are less clear.[100]

What is more, higher output, lower costs, and better outcomes (for *upstream* firms) are not necessarily proof of technical efficiency. First, there are less restrictive means available to upstream franchisors to reduce conflicts of interest with franchisees than resale price maintenance and exclusive dealing contracts. Upstream firms can provide information and services to consumers directly or through third parties, or share upstream profits with distributors under the threat of termination for non-compliance. Second, as discussed earlier, restraints like non-compete agreements, right of first refusal to sale, mandatory arbitration, and choice of forum clauses lower the value of the franchisee's next-best alternative or "outside"

[97] G. F. Mathewson & R.A. Winter, *An Economic Theory of Vertical Restraints*, 15 RAND J. ECON. 27 (1984); ROGER D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING 117-38 (2010).

[98] James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT. J. INDUS. ORG. 639 (2005); Lafontaine & Slade, *supra* note 91. For a critique of the methodologies used and conclusions reached by these studies, *see* Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962, 1988 n.103 (2018).

[99] Kwoka & Slade, *supra* note 5.

[100] Asker & Bar-Isaac, *supra* note 5.

option, inducing franchisees to exert even more effort than they bargained for when they signed the contract. But the output has not really increased per unit input. Rather, vertical restraints have coerced the franchisee into supplying more of the effort input.[101] Imposing a brute force, effort-maximizing sweating system through disempowering contract terms does not increase output in the same way as, for example, investing in labor-saving technology (indeed it may substitute for such investments).

IV
THE FTC CAN RESTORE INDEPENDENCE OF "INDEPENDENT" BUSINESSES

The FTC has broad power to establish rules of fair competition and fair dealing. Under Section 5 of the FTC Act, the Commission has the power to prohibit "unfair methods of competition" and "unfair or deceptive acts and practices".[102] Per a long line of Supreme Court precedent, the Commission's power is expansive and not confined by the scope of the Sherman and Clayton Acts (the two principal federal antitrust statutes). The Commission should use this authority to restrict or prohibit a range of price or non-price vertical restraints.

Under established precedent, the FTC has expansive authority to enact rules of fair competition under Section 5 of the FTC Act. In a landmark 1972 decision on the scope of the FTC's power, the Supreme Court stated that the Commission can operate as a "court of equity" and "consider[] public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws."[103] The Supreme Court affirmed this standard in a 1986 decision.[104] These two decisions followed a series of decisions in the postwar authority that recognized the FTC's broad power under Section 5.[105] The Commission's expansive authority is in line with the legislative intent of the FTC Act. The drafters of the FTC Act aimed to

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101 ALAN FELSTEAD, THE CORPORATE PARADOX: POWER AND CONTROL IN THE BUSINESS FRANCHISE 60, 190 (1993).

102 15 U.S.C. § 45 (2018).

103 FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 244 (1972).

104 *Indiana Fed'n of Dentists*, 476 U.S. at 454.

105 *See e.g.*, *Brown Shoe*, 384 U.S. at 322 (1966) ("[T]he Commission has power under § 5 to arrest trade restraints in their incipiency without proof that they amount to an outright violation of § 3 of the Clayton Act or other provisions of the antitrust laws."); FTC v. Motion Picture Advert. Serv. Co., 344 U.S. 392, 394 (1953) ("[T]he Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act.").

create a national policymaker on fair competition that would function as a quasi-legislative and quasi-adjudicatory arm of Congress.[106] Because Supreme Court decisions such as *Sylvania*, *Khan*, and *Leegin* were judicial interpretations of the Sherman Act, the FTC is not constrained by them in interpreting the FTC Act.

The FTC should use its expansive unfair methods of competition authority against vertical restraints. It should rule certain restraints as per se (or categorically unlawful), other restraints as presumptively unlawful and subject to rebuttal (through the presentation and verification of business justifications), and yet other restraints as per se illegal only for firms with dominance in their market.

A. Per Se Illegal

For restraints that restrict labor mobility and autonomy for workers and proprietors, the FTC should adopt or affirm rules of per se illegality. Non-compete clauses restrict where workers can go and what they can do after leaving a position and, in limiting exit options, can bind workers to their current job.[107] No-poach agreements limit rival employers from recruiting each other's workers, whether instituted bilaterally or by a franchisor, which similarly restrict exit options for workers. Both restraints have comparable negative effects on worker mobility[108] and wages[109] and rest on dubious justifications.[110] The FTC should prohibit them as per se illegal through rulemaking in the case of non-compete clauses[111] and affirm

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106 For a comprehensive analysis on the creation of the FTC, *see* Marc Winerman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. 1 (2003).

107 The main justification for a business owner signing a non-compete upon sale of a business is that the purchaser is acquiring the goodwill. A retiring doctor selling their practice would be expected to agree to a non-compete agreement because their re-entry after sale would compromise the goodwiller that the purchaser acquired. Since franchise contracts assign the goodwill to the franchisor and its associated trademark, not the franchisee, this justification does not apply to franchise contracts.

108 Evan Penniman Starr, J.J. Prescott, & Norman David Bishara, *Noncompetes and Employee Mobility*, ACAD. MGMT. PROC. (2019); Evan Starr, Justin Frake, & Rajshree Agrawal, *Mobility Constraint Externalities*, 30 ORG. SCI. 961, 966-67 (2018).

109 U.S. DEP'T OF TREASURY, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS 6 (2016).

110 Viva R. Moffat, *The Wrong Tool for the Job: The IP Problem with Noncompetition Agreements*, 52 WM. & MARY L. REV. 873 (2010).

111 The Open Markets Institute, where the two authors are employed, petitioned the FTC to ban non-compete clauses through rulemaking in March 2019. *See* Open Markets Institute et al., Petition for Rulemaking to Prohibit

existing per se prohibitions on no-poach arrangements among competing employers.[112]

Franchise restraints that compel certain hours of operation should also be per se illegal. These restraints rob nominally independent businesses of a basic proprietary discretion: the freedom to decide when to be open for serving the public. As a court wrote in 1951:

> When, in law, we speak of "an independent contractor", or "an independent business man," we deal with a practical concept, not with a philosophical phrase. We mean a person who, in the performance of a particular contract, or in the conduct of his business, acts chiefly for himself and for his own benefit and profit, and not for others and the benefit and profit of others.[113]

Mandatory hours of operation contravene this notion of independence. They either compel labor on the part of proprietors or force them to hire additional workers to provide, for example, service 24 hours a day, seven days a week. Mandated hours of operation are inconsistent with independent business status in which proprietors have discretion over when to serve customers. To preserve effective independence for "independent" businesses, the FTC should prohibit this restraint as per se illegal.

B. Presumptively Illegal

A per se rule against price restraints and territorial restrictions would be too strong, as these restraints have different effects depending on the balance of power between the upstream and the downstream firm. Price restraints, when established between a new entrant or less powerful upstream firms and a distribution outlet, can help upstream firms enter new markets and protect their brand names. New entrants or less powerful upstream firms may also have cause to impose exclusive territories or maximum prices to break into new markets in competition with established competitors. Territorial restraints guarantee a stable geographic market to the distributor, inducing them to take on the risk of

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Petition for Rulemaking to Prohibit Worker Non-Compete Clauses (March 2019), https://static1.squarespace.com/static/5e449c8c3ef68d752f3e70dc/t/5eaa04862ff52116d1dd04c1/1588200595775/Petition-for-Rulemaking-to-Prohibit-Worker-Non-Compete-Clauses.pdf [https://perma.cc/D4KA-GE9H].

112 Palmer v. BRG of Ga., Inc., 498 U.S. 46, 49 (1990) (per curium); In re Ry. Indus. Emp. No-Poach Antitrust Litig., 395 F. Supp. 3d 464, 481 (W.D. Pa. 2019).

113 United States v. Richfield Oil Corp., 99 F. Supp. 280, 288 (S.D. Cal. 1951), *aff'd sub. nom.* Richfield Oil Corp. v. United States, 343 U.S. 922 (1952).

distributing a new product.

These cases, however, are likely to be the exception. For the reasons given in this paper, protection of functional business independence requires in most cases for distributors and retailers to retain business autonomy and discretion over prices and customers. Price and territory restrictions, especially when imposed by a more powerful party on the weaker, undercut this notion of independence. To preserve effective independence for "independent" businesses, the FTC should find these restraints presumptively illegal.[114] The presumption should apply unless the upstream firm can demonstrate that the restraints are necessary to allow it to enter a market and that neither the upstream firm nor the downstream firm control an undue share of their relevant markets.

C. Illegal by Dominant Firms

The FTC should prohibit certain restraints and practices only for dominant firms. In defining what constitutes market dominance, the FTC should use market share or firm size. For instance, a share of 30% or more in a relevant market would be a reasonable measure of dominance and in line with current Sherman Act definitions of "market power."[115] Corporate size can be a source of power too.[116] This is especially true when there is great inequality in size. In his dissent in the 1965 case *Atlantic Refining,* Justice Stewart wrote, "*The disparity in size and financial strength*, the short term of the prevailing leases, the dire financial consequences attendant upon lease cancellation, and the established market preference for certain brands of gasoline—all contribute to give Atlantic a leverage over its dealers and a corresponding power to effect some exclusion of competition."[117]

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114 The courts have held that certain horizontal restraints should be treated as presumptively illegal under the application of a "quick look" rule of reason. *See, e.g.*, Polygram Holding, Inc. v. FTC, 416 F.3d 29, 35, 37 (D.C. Cir. 2005).

115 *See, e.g.*, United States v. Visa U.S.A., Inc., 344 F.3d 229, 240 (2nd Cir. 2003) ("[T]he court inferred market power from the defendants' large shares of a highly concentrated market: In 1999, Visa U.S.A. members accounted for approximately 47% of the dollar volume of credit and charge card transactions, while MasterCard members accounted for approximately 26%.").

116 *See e.g.*, *Shell*, 360 F.2d at 479-80 ("First, Shell has dominant economic power over its dealers similar to Atlantic's power over its dealers. Shell too is a major integrated producer, refiner, and distributor of petroleum products. In 1955, when the record closed, Shell sold about 5 per cent of the total gasoline sold in the United States, and had annual operating revenues exceeding $1,700,000,000.").

117 *Atlantic Refining*, 381 U.S. at 380 (Stewart, J., dissenting) (emphasis

For dominant firms, the FTC should prohibit the following competitive practices. First, the FTC should ban exclusionary contracts that restrict the freedom of trading partners to do business with rivals.[118] Second, it should affirm and strengthen existing prohibition on the tying or bundling of separate products in which a purchaser must take a second product as a condition of purchasing one product.[119] When dominant firms engage in these practices, they coerce trading partners and use their power to unfairly exclude rivals from one or more markets. In contrast, when non-dominant firms employ exclusionary contracts or tying, the coercion threat is mitigated because trading partners have alternatives and can decline the exclusionary contract or bundle. Moreover, the exclusionary potential is limited when a firm has a market share of five or 10 percent, as opposed to 30 or 40 percent.[120]

D. Work Law Considerations

While antitrust is the body of law best suited for regulating the exercise of power across and outside the boundaries of the firm,[121] an alternative solution is to prevent the arbitrage in the first place. Why permit the manipulation of legal boundaries of the firm for purposes of regulatory arbitrage? Franchisors should not be able to get control consistent with vertical integration and employment relationships without the corresponding duties and obligations under work law.[122]

Vertical restraints can be used to improperly evade labor

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added).

118 The Open Markets Institute, where the authors work, petitioned the FTC to write such a rule in July 2020. *See* Open Markets Institute et al., Petition for Rulemaking to Prohibit Exclusionary Contracts (July 2020), https://static1.squarespace.com/static/5e449c8c3ef68d752f3e70dc/t/5f1729603e615a270b537c3d/1595353441408/Petition+for+Rulemaking+to+Prohibit+Exclusionary+Contracts.pdf [https://perma.cc/Y9B6-KVEJ].

119 Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 462-63 (1992). In the sale of goods, the Clayton Act prohibits tying arrangements "where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." 15 U.S.C. § 14 (1914).

120 The Supreme Court held that per se condemnation of tying is appropriate when a seller has the "kind of market power that enables him to force customers to purchase a second, unwanted product in order to obtain the tying product. . . ." Jefferson Par. Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16-18 (1984), *abrogated on other grounds by* Illinois Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006).

121 Marshall Steinbaum, *Common Ownership and the Corporate Governance Channel for Employer Power in Labor Markets*, 66 ANTITRUST BULL. 123, 138 (2021).

122 Brian Callaci, *Control Without Responsibility: The Legal Creation of Franchising 1960-1980*, 22 ENTERPRISE & SOC'Y 156 (2021).

and employment laws in two related ways. First, vertical restraints can help firms to misclassify employees as independent contractors. In misclassification, vertical restraints substitute directly for a legal employment relationship, giving firms tight, prescriptive control over workers while allowing them to deny the rights associated with employment. For example, Uber sets driver pay and prices while classifying them as independent contractors rather than employees.[123] Second, vertical restraints can help firms offload the duties and responsibilities of employment onto legally separate franchisees or contractors. Here, there are still workers properly classified as employees, but vertical restraints allow the lead firm to distance itself from those workers by making them the employees of a franchisor or contractor. As discussed in this paper, franchise contracts allow franchisors to exercise power and control across the boundaries of the firm, indirectly setting frontline worker wages and working conditions. Numerous scholars have argued that in many cases vertical restraints go so far as to create joint employer relationships between frontline workers and the lead firm.[124]

In determining where employment relationships exist, it is helpful to note that the essence of the independent business ownership is the exercise of true entrepreneurial initiative. By this we do not mean merely "risk of loss" or "profit,"[125] which exist under all kinds of incentive plans, but rather exercising entrepreneurial business initiative and discretion over the range of variables that determine profitability. Merely supplying labor effort, even under incentive plans that make workers residual claimants over output from their own increased effort, is not what common-sense meanings of entrepreneurship entail. Accordingly, vertical restraints that

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123 Steinbaum, *supra* note 8; Sanjukta Paul, *Fissuring and the Firm Exemption*, 82 L. CONTEMP. PROBS. 65 (2019).

124 Andrew Elmore & Kati L. Griffith, *Franchisor Power as Employment Control*, 109 CAL. L. REV. 1317 (2021) (draws attention to franchisor control through contractual restrictions, ongoing monitoring, communications, and evaluations); Kati L. Griffith, *An Empirical Study of Fast-Food Franchising Contracts: Towards a New "Intermediary" Theory of Joint Employment*, 94 WASH. L. REV. 171 (2019) (emphasizes franchisor influence on wages and working conditions through the franchisor's control of the franchisee's line supervisors); Callaci, *supra* note 87 (focuses on vertical restraints that reduce the bargaining power of both franchisees and workers); Andrew Elmore, *Regulating Mobility Limitations in the Franchise Relationship as Dependency in the Joint Employment Doctrine*, 55 UC DAVIS L. REV. 1227 (2021) (draws attention to mobility restrictions on franchisees and workers in franchise vertical restraints).

125 SuperShuttle DFW, Inc., 367 N.L.R.B. No. 75, 3 (Jan. 25, 2019).

remove franchisee or distributor discretion and prescribe their behavior create *de facto* employment relationships. Specifically, obligations to personally work in the franchised establishment, maximum price restraints, mandatory hours of operation, supplier restrictions, no-poaching agreements, product restrictions, digital monitoring of franchisee computer systems, and most of all unilateral changes to the operations manual prescribe franchisee behavior and remove franchisee discretion, treating them like employees.[126] For franchisees that employ workers, these restraints also make franchisors the *de facto* employer of the franchisee's employees, and the franchisor should have duties and obligations to those workers under joint employment doctrines.

Indeed, the entire business format franchising model, in which a franchisor licenses a franchisee to use its branded trademark under minutely prescribed rules, should be treated as presumptively a joint employment relationship. As Hiba Hafiz argues, since brands in arrangements like business format franchising use trademark law to exert detailed control over independent franchisees and their workers, those trademark licensing rights should be tied to bargaining obligations for the trademark owner across the franchise system or licensing network.[127]

E. Franchise Relationship Law Considerations

Finally, there are solutions to unfair and oppressive contracts outside of labor and antitrust law. Franchise relationship laws are on the books in many states to prevent franchisors from oppressing franchisees with burdensome and unfair contract terms, such as: unjust termination without cause, restrictions on the franchisee's ability to transfer or sell

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126 It is notable that the ability to make such unilateral changes to the operations manual gives franchisors effective "residual control rights" over the franchisee's assets, or the right to make all decisions concerning their use not specifically spelled out in the contract. According to property rights theory, one widely accepted theory of the firm, residual control rights are the defining feature of the boundaries of the firm: firms own assets rather than contract when it is more efficient for them to retain the right to make all decisions regarding those assets not explicitly stated in contract. *See* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990). The unilateral change to the operations manual clause in franchise contracts emphatically places franchisees inside the boundaries of the franchisor's firm—in other words, places them in the status of *de facto* employees.

127 Hiba Hafiz, *The Brand Defense*, 43 BERKELEY J. EMPL. & LAB. L. 1, 73 (2022).

their business, discriminatory treatment of franchisees, forum restrictions or mandatory arbitration clauses, and restrictions of franchisees' ability to freely associate with each other in franchisee associations. Such franchise relationship laws exist in several states.[128] At the federal level, statutory law protects auto dealers[129] and gas station franchisees,[130] although the latter's protections consist of a right to certain upfront disclosures from franchisors and so are more procedural than substantive.[131] Franchisee relationship laws can help protect franchisees from abuses of power that are not reached by antitrust laws.

The Federal Trade Commission's trade regulation rule requires all franchisors to disclose these contract terms to franchisees in plain English. Franchisees, however, have long pointed out the power imbalance between franchisors and franchisees, and the lack of business experience of most franchisees renders these protections insufficient.[132] Franchise relationship laws, whether instituted at the federal or state level, are the appropriate remedy in these cases.

CONCLUSION

Continental TV vs. GTE Sylvania, the seminal case of the Law & Economics movement, concerned the legality of a manufacturer restricting the autonomy of a downstream independent distributor through vertical restraints. The Supreme Court initiated a revolution in antitrust law when it ruled in favor of the manufacturer and placed vertical restraints under the rule of reason. Even as the economics profession has moved on from the simplistic version of welfare

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128 While there is no universally agreed-upon definition of what rises to the level of a franchise relationship law, one list of which states have relationship laws on the books can be found here: Franchise & Business Law Group, Franchise Laws by State (2022) https://www.franchisebusinesslawgroup.com/what-are-the-different-franchise-laws-by-state/ [https://perma.cc/FD5H-CBPV].

129 The Automobile Dealer's Day in Court Act, 15 U.S.C. §§ 1221-25 (1970).

130 The Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-06 (1988).

131 Thomas M. Pitegoff & W. Michael Garner, *Franchise Relationship Laws, in* FUNDAMENTALS OF FRANCHISING 198 (Rubert M. Barkoff and Andrew C. Selden, eds., 2008).

132 Callaci, *supra* note 122; Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate Over Franchise Relationship Laws*, 76 ALB. L. REV. 193 (2012); Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 DICK. L. REV. 105 (2004); Peter C. Lagarias & Robert S. Boulter, *Modern Reality of the Controlling Franchisor: The Case for More, Not Less, Franchisee Protections*, 29 FRANCHISE L.J. 139 (2010).

economics that Law & Economics scholars and jurists imported into law with *Sylvania*, the consequences of that case for independent businesses and workers have been profound.

Over the decades since *Sylvania*, corporations have seized on the opportunities the Supreme Court opened up to decrease vertical integration and increase subcontracting—fissuring their workplaces and denying workers employment rights in the process. Although not all fissured workplaces rely on vertical restraints, they are the major mechanism behind fissuring in industries like hotels, restaurants, convenience stores, and gas stations. Economist David Weil, the leading scholar of the fissured workplace, estimates a lower bound to its size at nineteen percent of the private workforce.[133] It is now possible to "own" a small business and yet have no entrepreneurial discretion over such basic business decisions as which customers to serve, what prices to charge, which suppliers to purchases from, and what hours to operate. Independent entrepreneurship and working conditions have been degraded in the process.

The Federal Trade Commission has broad authority to identify and prohibit "unfair methods of competition." This power extends beyond conduct that violates the antitrust statutes to practices that the Commission determines are against public policy. The FTC should exercise its authority and clarify the legal status of vertical restraints, prohibiting the most restrictive restraints (non-compete clauses, no-poaching clauses, mandatory hours of operation), declaring less restrictive restraints presumptively illegal (territorial and price restraints), and prohibiting exclusive dealing and tying by dominant firms.

Non-compete clauses, no-poaching clauses, and mandatory hours of operation are inconsistent with independent business ownership, full stop. Independent entrepreneurs must have entrepreneurial discretion over the range of variables affecting profitability to function as independent business owners. Merely choosing whether to apply more or less effort along prescribed channels is more consistent with employment status than entrepreneurship, even if the individual faces risk of loss and has the opportunity for profit from that effort. Firms cannot simply shift risk onto workers and call it entrepreneurship. As such, the FTC should

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133 David Weil, *Understanding the Present and Future of Work in the Fissured Workplace Context*, 5 RSF: THE RUSSELL SAGE FOUNDATION JOURNAL OF THE SOCIAL SCIENCES 147, 151 (2019).

find this class of vertical restraints to be per se illegal.

Meanwhile, the use of price and territorial restraints are rarely justified. These restraints also remove discretion over key variables from the entrepreneur's choice set and are especially pernicious when imposed by strong firms on weaker trading partners. However, in some cases new entrants and certain specialty upstream firms—especially those with lower bargaining power than downstream trading partners—may have a legitimate interest in requiring distributors and franchisees to adhere to prescribed pricing rules while providing guaranteed territories. In these cases, facilitating the upstream firm's ability to compete downstream against vertically integrated or otherwise established competitors may outweigh the coercive nature of these restraints. Such situations are likely to be rare though, so these restraints should be presumptively illegal, prohibited unless the upstream firm can demonstrate that the restraints are necessary to allow it to enter a market and that neither the upstream firm nor the downstream firm control an undue share of their relevant markets. Exclusive contracts and tying should be illegal for dominant firms. The use of these restraints by dominant firms coerce trading partners and unfairly exclude potential competitors. By contrast, when non-dominant firms employ exclusive contracts and tying, the effect is not as coercive, because downstream firms have other options and are in a position to refuse the exclusionary or tying contracts.

Too often vertical restraints are deployed as a kind of legal arbitrage, allowing powerful firms to control nominally independent businesses through contracts that create relationships much closer to employment than contracting between truly independent firms. Antitrust and other areas of law, particularly work law, should work together to prevent this arbitrage from happening. This essay has focused on antitrust law, particularly the FTC's ability to police unfair methods of competition, which is the area of law best suited to protecting independent business people from domination and unfairly coercive contracts. Work law, however, can help give nominally independent businesspeople employment protections more consistent with their status as de facto employees, as well as give the employees of business people controlled by vertical restraints employment rights against the firm that really controls their working conditions. Finally, franchise relationship laws, which protect franchisees and distributors from certain forms of abuse by powerful franchisors, such as unjust termination and non-renewal of franchise contracts, can guard against forms of abuse that pertain more to unfairly expropriating franchisee wealth than excessive coercion through vertical restraints.