

Schwinn: The Last Word in Franchises

Trial judge discusses facts of case, findings of his Court and Supreme Court

BY JUDGE JOSEPH S. PERRY*

I will discuss one of the most important antitrust cases decided by the Supreme Court since World War II. It is *United States v. Arnold, Schwinn & Co., et al.*, 388 U.S. 365. I should know a great deal about it and I do, but I am not sure that I fully understand the Supreme Court's decision. And I do not know of any judge or lawyer who professes to do so.

That case was tried before me for 77 trial days and the trial extended over a six-month period, with some interruptions. It was a nonjury trial. There were upwards of 15,000 pages of testimony. As many of you know, it is the last word in franchises; but many lawyers look upon its pronouncements in the same manner as the words of the ancient Greek oracle Delphi.

The reason for the great length of the trial was that the government sought to establish that Schwinn was guilty of price-fixing. If that could be proved, then a *per se* violation would be shown and Schwinn's whole system of franchising could be enjoined without proof that its franchising was unlawful. The Government wanted to make a test case out of the *Schwinn* lawsuit. And God help any defendant when the full force of the government's investigative resources and legal talent is arrayed against him.

The government brought in scores of distributors, retail franchisees, customers and investigators from Maine to California, like swarms of locusts. No matter how hard the government tried, it could not and did not prove any price-fixing. The government did not appeal my findings of no price-fixing but accepted them.

The government then resorted to its proof, seeking to show unreasonable restraint of interstate commerce. Schwinn had divided the United States into areas of primary responsibility and assigned a distributor to each area. Upon advice of counsel, Schwinn made it clear to each distributor that such distributor would get credit for direct sales to each franchise retailer in its given area and urged but did not prohibit a retailer from purchasing Schwinn products — bicycles — from a distributor in another area. That urging sometimes took the form of strong per-

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Judge Perry

suation. The government sought to show that it amounted to coercion; but the evidence failed to prove conspiracy or coercion.

Schwinn was a family-owned corporation that has manufactured and sold bicycles for almost a century. It was a relatively small corporation compared to its com-

From LES U.S.A. Central Region Meeting

petitors. In fact it was a pygmy compared to Sears Roebuck, its strongest competitor. The contest between the two for the American bicycle market might be compared to a battle between a mouse and an elephant. However, the mouse did quite well in the struggle. It did so by devising a unique plan.

Sears was able to fix a uniform price and require every branch store in the United States to adhere to that price. That was perfectly legal; for Sears had a lawful right to fix prices of its own without being "called upon the carpet" for violating an antitrust statute.

But Schwinn could not fix the price for which its distributors sold bicycles to their retail franchisees. Nor could Schwinn fix the price at which the franchisees retailed their bicycles which they owned. Schwinn developed a system that required each franchisee to provide service for its customers. It then instituted a dual sales plan whereby a distributor could take an order from a franchisee and fill it from his own stock or have the order filled by Schwinn from the factory in Chicago. If the order was filled by Schwinn directly the invoice was sent by Schwinn to the franchisee who paid Schwinn directly. Schwinn then forwarded the agreed commission to the distributor. Schwinn also accepted direct orders from franchisees, and when payment was made Schwinn forwarded the agreed commission to the distributor for the territory in which the franchisee was located.

The distributors still performed a valuable function. A franchisee in Los Angeles, California, or Portland, Maine, could get delivery overnight, instead of waiting for a week or so, if he dealt directly with Schwinn. Schwinn also delivered bicycles to its distributors on a consignment basis and retained ownership and fixed sale prices on them.

Huge Success

On the whole, the Schwinn plan was a huge success. Schwinn could and did fix its prices to retail franchisees. While Schwinn urged its retailer franchisees to maintain the retail price that Schwinn suggested, Schwinn took no action to penalize those franchisees who did not adhere to Schwinn's suggested retail price. The overall result was

that Schwinn was thus enabled to compete successfully with Sears.

Upon the whole record I found that Schwinn was not guilty of violating the anti-trust statutes in a material manner. The case was appealed directly to the Supreme Court which modified my decree in its well-known decision.

If I should be asked to briefly outline the Supreme Court's holding in the *Schwinn* case, I would summarize the holding as follows:

Schwinn is not bottomed upon an exclusive agreement. The Schwinn Company permitted all of its distributors and franchisees to sell the bicycles of any and all other manufactures. That was the saving grace for Schwinn. The Supreme Court modified my decree; but the Court essentially held that territorial restrictions cannot be imposed upon customers by a manufacturer after he has parted with title; dominion and risk. In other words, mere consignment is not enough. The Court approved the use of distributors as mere agents so long as Schwinn kept title, billed the franchisee direct, and paid the insurance on bicycles while stored on the premises of the distributor, without the distributor assuming any risk other than its own negligence.

More Understandable

I will attempt to put the Supreme Court's ruling in even more understandable language.

The Supreme Court told Schwinn that it could designate distributors for geographic areas and designate retail franchisees in those areas, but that Schwinn could not prevent distributors from competing with each other. For example, Schwinn could not prevent a distributor in Springfield, Illinois from selling to customers assigned to a St. Louis, Missouri distributor. The Supreme Court told Schwinn that to do so restrained commerce. Neither could Schwinn prevent a retail franchisee in Chicago from making retail sales in Oak Park or *vice versa*. Again the Supreme Court said that was restraint of commerce. Schwinn could suggest areas of prime responsibility — but suggest was all. Schwinn could not penalize any distributor who did not follow its suggestion.

Now that is not as bad as it may sound. For actually the economics of doing business limits competition between distributors and franchisees alike. While a St. Louis, Missouri distributor may compete successfully with a Springfield, Illinois distributor in Illinois territory, which is as near or nearer to St. Louis than to Springfield, the St. Louis distributor will find that it does not pay to send salesmen to Urbana, Illinois. Besides, the extra freight

and transportation charges consume all the profit. So, actually, the Supreme Court's decision is not much of a handicap to Schwinn, its distributors and franchisees so far as competing with each other is concerned.

It is equally clear that Schwinn cannot fix bicycle prices which its distributors charge franchisees, nor the price that franchisees can sell at retail. Again, Schwinn can only suggest and cannot penalize a distributor or franchisee for disregarding its suggested prices.

The Court mandated that Schwinn could not deliver to a distributor bicycles on consignment and control the prices or to whom they were sold unless Schwinn retained title, paid the storage, paid insurance and billed the ultimate franchisee who purchased bicycles and relied solely upon the credit of the franchisee for payment, treating the distributor as a sales agent only, not relying upon the distributor for payment. The Court required Schwinn to place itself in the same relationship as that of Sears with its customers. Thus Schwinn was left free to deal with distributors in a dual capacity — as a distributor for bicycles that it purchases and keeps in stock and as a sales agent for bicycles shipped directly to a franchisee, held in storage on a consignment basis purely as a sales agent for Schwinn. This made no sense to the officials of Schwinn. Why should the company have to invest capital to own bicycles, pay for storage and insurance, and assume all credit risks, in order to control the sale price by its distributors, and then be faced with sales by the same distributors to Schwinn's own retail franchisees at prices over which Schwinn had no control? Consequently, Schwinn simply terminated all of its independent distributors. Instead, Schwinn established its own wholly-owned agencies in strategic locations throughout the United States. It retains title to bicycles, bills its franchisees direct, pays its own storage, insurance and other costs attendant to ownership. It is, therefore, in compliance with the Supreme Court's decision and is no worse off. Schwinn makes no effort to control the resale price at which its franchisees sell the bicycles. It only suggests a price to them. They are free to meet retail competition with such prices as they choose.

The only people who suffered were the independent distributors. They lost their agreements to act as distributors for Schwinn.

I have made no attempt to cover the fair trade laws of various states which are exempted from the antitrust laws. Illinois and 12 other states have such laws which give the manufacturer and his retail outlet the right to fix fair prices of products and adhere to them. The laws in the other 37 states are not effective and those laws in Illinois and the 12 other states are actually falling into disuse. That is a field too complicated to deal with except in a discussion limited to such laws.