

sion a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist as set forth herein.

IN THE MATTER OF
CARVEL CORPORATION ET AL.

ORDER, OPINION, ETC., IN REGARD TO THE ALLEGED VIOLATION OF THE
FEDERAL TRADE COMMISSION ACT

Docket 8574. Complaint, June 5, 1963—Decision, July 19, 1965

Order setting aside the initial decision of the hearing examiner and dismissing the complaint which charged a Yonkers, N.Y., manufacturer of soft ice cream freezers and other equipment and six allied companies with illegally restraining trade and lessening competition through numerous restrictions placed upon their independent franchised soft ice cream dealers.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, the Federal Trade Commission, having reason to believe that

*Reported as amended by Commission's order of October 7, 1965.

the party respondents named in the caption hereof, and herein-after more particularly designated and described, have violated and are now violating Section 5 of the Federal Trade Commission Act (U.S.C., Title 15, Sec. 45) and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, the Commission hereby issues its complaint stating its charges as follows:

PARAGRAPH 1. Respondent Carvel Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. On August 2, 1946, respondent's corporate name was changed from Dairy Whip Co., Inc., to the name Carvel Corporation. Respondent Carvel Corporation is presently engaged in the production of soft ice cream freezers and other machinery and equipment which are offered for sale, sold or leased to retailer-manufacturers of soft ice cream. Respondents Thomas Carvel and Agnes Carvel are president and treasurer, respectively, of said respondent corporation.

Respondent Dari-Freeze Stores, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. Respondent was originally incorporated under the name Carvel Dari-Freeze Stores, Inc., and on January 16, 1961, the name was changed to Dari-Freeze Stores, Inc. Respondent Dari-Freeze Stores, Inc., is engaged in the business of selling and leasing soft ice cream machinery, and contracting for the sale of or selling soft ice cream mix, commissary goods and other products to soft ice cream dealers. Respondent Dari-Freeze Stores, Inc., owns 100% of the stock of respondent Dari-Freeze Stores of New Jersey, Inc. Respondents Thomas Carvel and Agnes Carvel are first vice president and treasurer, respectively, of respondent Dari-Freeze Stores, Inc.

Respondent Franchised Stores of New York, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. Respondent is certified to do business in Pennsylvania, Connecticut, Florida, New Jersey, Massachusetts, and Maryland. On February 15, 1955, respondent's corporate name was changed from Stramar Corporation to the name of Carvel Stores of New York,

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Inc., and on January 16, 1961, was subsequently changed to the present name Franchised Stores of New York, Inc. Respondent Franchised Stores of New York, Inc., is engaged in the business of licensing franchised dealers to sell soft ice cream and other products, and contracting for the sale of or selling soft ice cream mix, commissary goods and other products to the aforementioned franchised dealers. Respondents Thomas Carvel and Agnes Carvel are first vice president and assistant treasurer, respectively, of respondent Franchised Stores of New York, Inc.

Respondent Stores of Pennsylvania, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. Respondent was originally incorporated under the name Carvel Stores of Pennsylvania, Inc. and on April 7, 1961, the name was changed to Stores of Pennsylvania, Inc. Respondent Stores of Pennsylvania, Inc., is engaged in the business of licensing franchised dealers to sell soft ice cream and other products, and contracting for the sale of or selling soft ice cream mix, commissary goods and other products to the aforementioned franchised dealers. Respondents Thomas Carvel and Agnes Carvel are president and treasurer, respectively, of respondent Stores of Pennsylvania, Inc.

Respondent Dari-Freeze Stores of New Jersey, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New Jersey, with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. Respondent was originally incorporated under the name Carvel Dari-Freeze Stores of New Jersey, Inc., and on January 16, 1961, the name was changed to Dari-Freeze Stores of New Jersey, Inc. Respondent Dari-Freeze Stores of New Jersey, Inc., is engaged in the business of licensing franchised dealers to sell soft ice cream and other products, and contracting for the sale of or selling soft ice cream mix, commissary goods and other products to the aforementioned franchised dealers. Respondents Thomas Carvel and Agnes Carvel are president and treasurer, respectively, of respondent Dari-Freeze Stores of New Jersey, Inc.

Respondent Chain Locations of America, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. On August 30, 1957, respondent's corporate name was changed from Carvel Stores Realty Corp., to the name Chain

Locations of America, Inc. Respondent Chain Locations of America, Inc., negotiates with the owners of real estate for the purpose, among others, of providing sites for Carvel franchised stores.

Respondent Carvehicle Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York with its principal office and place of business located at 430 Nepperhan Avenue, Yonkers, New York. Respondent Carvehicle Corporation is engaged in the business of licensing franchised dealers to sell soft ice cream and other products and contracting for the sale of or selling soft ice cream mix, trucks used for the dispensing of soft ice cream, commissary goods and other products to the aforementioned franchised dealers. Respondent is certified to do business in New Jersey, Pennsylvania, Connecticut, Maryland and Wisconsin.

PAR. 2. The individual respondents named herein formulate, direct and control the policies, acts and practices of the respective corporate respondents of which they are officers.

Respondent Thomas Carvel is owner of the trade-mark "Carvel" for frozen food products and the service-mark "Carvel" for serving food and beverages at road-side stands. Other trade-marks owned by respondent Thomas Carvel include "Carvel * * * imitated, but never duplicated," "Dari-Freeze," and "Flying Saucer." The franchised dealers licensed by corporate respondents to sell soft ice cream and other products, sell these products under the aforementioned trade-marks and service-marks.

PAR. 3. The named corporate respondents herein when referred to collectively, will hereinafter be referred to as "Carvel."

The terms "Carvel Dealers" or "dealers" are hereinafter used to designate dealers franchised by the aforementioned Carvel.

The term "commissary goods" is hereinafter used to designate syrups, toppings, flavorings, extracts, fruits, cones and other products used on and in connection with the sale of soft ice cream.

The term "equipment" is hereinafter used to designate freezers, hardening cabinets, ice cream trucks and other machinery and devices used in the manufacture and sale of soft ice cream.

The term "soft Ice cream" is hereinafter used to designate and mean an ice cream product, hardened for less than twelve hours, and generally sold from road-side stands or ice cream trucks and dispensed from direct-serve machines.

PAR. 4. Commencing in 1947, Carvel began to establish a network of Carvel dealers who operate road-side stands, or vehicles that dispense soft ice cream products to the consuming public

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under the aforementioned names "Carvel" or "Dari-Freeze." Individuals were attracted as a result of extensive advertising by Carvel containing various representations concerning potential profits, absence of failures, and selection of lucrative locations by experienced engineering staffs. Dealerships were created by a Franchise Agreement and other contracts and agreements setting forth the terms and conditions for operation of the franchise. Thus, Carvel established approximately 300 independent Carvel dealers who now operate in many areas of the United States, including the States of New York, New Jersey, Pennsylvania, Connecticut, Massachusetts, Wisconsin, Indiana, Maryland and Florida.

All corporate and individual respondents herein named are now and have been for several years last past engaged in one or more phases of the establishment of Carvel dealerships and/or contracting for the sale of or selling to Carvel dealers of soft ice cream mix, commissary goods, equipment, and other products. In addition to sums received in connection with the sale of soft ice cream mix, commissary goods, equipment, and other products, Carvel receives royalties from the dealers. Carvel's total sales are substantial, amounting to approximately \$5,000,000 in 1959.

PAR. 5. The corporate respondents are engaged in interstate commerce, as "commerce" is defined in the Federal Trade Commission Act, in that they, through the direction and control by respondent officers cause various products including substantial amounts of soft ice cream mix, commissary goods, and equipment to be shipped to purchasers located in the various States of the United States other than the states of origin, and there has been a constant current of trade in commerce in said products between and among the various States of the United States, and in connection with the carrying on of their said business of establishing Carvel dealerships and contracting for the sale of or selling the aforementioned products to these dealers, respondents send and receive orders, information, signs, advertising material and equipment relating to the said business and the products thereof, and, in general, promote said business through interstate commerce.

PAR. 6. In the course and conduct of their business, as herein described, corporate respondents have been for many years and are now in substantial competition in the sale of soft ice cream mix, commissary goods and other products with other corporations, persons, firms and partnerships engaged in the sale of these products in commerce between and among the various States of the United States, except to the extent that such competition has been re-

strained, lessened, or eliminated by the unlawful acts and practices hereinafter alleged.

PAR. 7. In the course and conduct of their business in commerce as above described, the corporate respondents acting under and through the direction and control of respective respondent officers have engaged and are now engaging in the following acts and practices:

(a) Have entered into and are now continuing in full force and effect the aforementioned Franchise Agreements with Carvel dealers. Said Agreements provide that Carvel dealers shall purchase only from Carvel or from specific sources designated by Carvel the dealers' entire supply of soft ice cream mix, commissary goods, and other products purchased by the dealers;

(b) Have precluded and are now precluding the Carvel dealers from purchasing and selling products, goods, wares and merchandise not authorized by Carvel;

(c) Have forced and are now forcing the Carvel dealers to purchase unnecessary and/or undesired equipment.

PAR. 8. The corporate respondents acting under and through the direction and control of respective respondent officers have compelled and are now compelling the Carvel dealers to comply with the restrictions cited in paragraph seven above by use of the following methods, among others:

(a) Have threatened and are now threatening Carvel dealers with cancellation of their Franchise Agreements if products are purchased from nondesignated sources or unauthorized products are sold. The threat of cancellation of said agreements is the basis of the economic control exercised by respondents over the dealers. This economic control is inherent in the power respondents have by virtue of the various agreements and contracts respondents have with dealers that run concomitantly with the Franchise Agreements. These related agreements which include various leases, options, and assignments, enable respondents, upon the cancellation of the Franchise Agreements to acquire a dealer's property at a fraction of its real value. Moreover, if the franchise is cancelled by respondents, the dealer's future livelihood is placed in jeopardy by reason of the fact that he may not operate any frozen dairy product stand for five years within a 25 mile radius of his former place of business;

(b) Have policed and are now policing Carvel dealers by a rigid system of surveillance and inspection to determine if products are purchased from non-designated sources and/or unauthorized products are being sold;

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(c) Have threatened and are now threatening Carvel dealers with legal action if products are purchased from non-designated sources and/or unauthorized products are being sold.

PAR. 9. In connection with respondent's policy of requiring Carvel dealers to purchase only from designated sources and to sell only authorized products, corporate respondents, acting through and under the direction and control of respective respondent officers, have engaged in and are now engaging in the following additional acts and practices:

(a) Have entered into and are now continuing in full force and effect agreements with dairies and other suppliers which provide that said dairies and other suppliers may not sell and deliver soft ice cream mix and commissary goods to Carvel dealers under the suppliers' names or any other names except Carvel;

(b) Have entered into and are now continuing in full force and effect agreements with dairies and other suppliers that provide that these suppliers are given an exclusive area of distribution and may not sell to Carvel dealers outside of the exclusive area of distribution; and all Carvel dealers located in the suppliers' designated area are required to purchase their entire supply of soft ice cream mix and other products from the designated suppliers;

(c) Have entered into and are now continuing in full force and effect agreements with dairies and other suppliers which fix the prices paid by Carvel dealers and further provide that Carvel shall receive commissions, "overrides," rebates or other payments for sponsoring, recommending, urging, inducing, or promoting the sale of soft ice cream mix, commissary goods equipment, and other products by these dairies and other suppliers;

(d) Have threatened and are now threatening legal action against nondesignated suppliers who attempt to sell products to Carvel dealers.

PAR. 10. The effects of the adoption and use of said restrictive agreements under the circumstances and in the manner alleged hereinabove by corporate respondents, have been, and are now, among others, as follows:

(a) Have deprived or have had the tendency to deprive, and are now depriving a substantial number of soft ice cream dealers of their right to act as independent businessmen by denying them freedom of choice as to the sources from whom they may purchase supplies and the products they may sell;

(b) Have coerced and are now coercing franchised dealers into complying with respondents' restrictive agreements in various ways, including but not limited to, agreements that unreasonably restrict dealers' activities after termination of the franchise;

(c) Have foreclosed or have had the tendency to foreclose and are now foreclosing a substantial amount of business to manufacturers, distributors, wholesalers and other vendors who compete with Carvel, and those sources under contract with Carvel in the sale of soft ice cream mix, commissary goods, and other products;

(d) Have injured, lessened, prevented and destroyed competition and are now injuring, lessening, preventing and destroying competition between dairies, commissary goods suppliers and suppliers of other products in agreement with Carvel, and manufacturers, distributors, wholesalers and vendors of soft ice cream mix, commissary goods and other products not designated as sources by Carvel.

PAR. 11. Said agreements between corporate respondents and Carvel dealers and between corporate respondents and dairies, commissary goods manufacturers and others, not parties herein, and the acts and practices of corporate respondents thereunder, acting under and through the control of respective respondent officers, as hereinabove alleged, are all to the prejudice of the public, have a tendency to and have unduly frustrated, hindered, suppressed, lessened, restrained, prevented and eliminated competition in the sale of soft ice cream mix, commissary goods, and other products in commerce within the intent and meaning of the Federal Trade Commission Act; have the capacity and tendency to restrain unreasonably such commerce in said products; and constitute unfair methods of competition and unfair acts and practices, in commerce, within the intent and meaning of Section 5 of the Federal Trade Commission Act.

Mr. Eugene Kaplan, Mr. Robert E. Liedquist, and Mr. Howard R. Lurie for the Commission.

Amen, Weisman & Butler, New York, N.Y., by Mr. Herman L. Weisman and Mr. Herbert F. Roth for the respondents, except Franchised Stores of New York, Inc.; and

Mr. Norman S. Isko, New York, N.Y. for Franchised Stores of New York, Inc.

Initial Decision

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INITIAL DECISION BY WILMER L. TINLEY, HEARING EXAMINER

MAY 25, 1964

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The Federal Trade Commission, on June 5, 1963, issued and subsequently served its complaint, charging the respondents named in the caption hereof with violations of Section 5 of the Federal Trade Commission Act. The charges were based essentially upon provisions of franchise agreements, and the use of methods, acts and practices pursuant thereto, requiring franchised dealers to purchase certain equipment and supplies only from respondents or from sources designated by respondents, and precluding them from purchasing and selling products not authorized by respondents.

Answers to the complaint, filed on August 12, 1963, on behalf of all of the respondents, contain various admissions and denials, and include a number of affirmative defenses. The respondents urge particularly that they "have not exceeded what they must and may legally do to protect the Carvel trademarks" (Ans., Par. 13), and that their purchases and sales represent an insignificant portion of the relevant market (Ans., Par. 15).

Non-public prehearing conferences were held with counsel in Washington, D.C., on August 22 and 27, 1963. On September 11, 1963, a prehearing order was filed by the hearing examiner scheduling the hearings to begin on October 7, 1963, with an allowance of two weeks for the presentation of the case-in-chief in support of the complaint, and a brief interval before beginning the defense. That interval was utilized by the hearing examiner to schedule the concluding hearings in another matter which had been suspended with the approval of the Commission.

Before the hearings started, counsel supporting the complaint requested that an additional week be scheduled for the presentation of their case-in-chief. This was granted with the result that the hearings were scheduled to suspend on October 18, 1963, and to

resume on October 28, 1963 (Order, 9-27-63). On October 3, 1963, counsel then representing respondents requested that the hearings scheduled to resume on October 28, 1963 be rescheduled to resume on November 4, 1963, urging important matters of convenience and necessity. The request was not opposed by counsel supporting the complaint, and was granted by the hearing examiner (Order, 10-4-63).

The hearings were held in New York, New York. Pursuant to the foregoing schedule, they began on October 7, 1963 and continued until October 18, 1963. They were resumed on November 4, 1963, and continued until November 21, 1963, when counsel supporting the complaint rested.

The transcript of testimony then amounted to more than 3300 pages, and counsel for respondents requested an interval for the purpose of reviewing the record in an effort to avoid offering needless defense evidence. Because it appeared to the hearing examiner that the interval would expedite, rather than delay, the hearings, the request was granted over the objection of counsel supporting the complaint (Tr. 3332-7). The presentation of defense evidence, accordingly, began on December 3, 1963, and continued until December 18, 1963, with an interval of two days on December 9 and 10 to permit negotiations of counsel with respect to returns on subpoenas duces tecum, study of the material supplied, and adjustments in the scheduling of witnesses (Tr. 3988-93).

On December 18, 1963, counsel for respondents rested, counsel supporting the complaint had no rebuttal and also rested, and the record was closed for the reception of evidence (Tr. 4811).

There were thirty-three days of hearings, during which more than 40 witnesses were presented by counsel supporting the complaint and 26 by counsel for respondents, some witnesses appearing on more than one occasion. The transcript of testimony covers approximately 4800 pages, many exhibits offered by both sides were received in evidence, and official notice was taken of certain matters at the request of counsel. In accord with the time and extensions granted by the hearing examiner, proposals and brief were filed by counsel supporting the complaint on March 23, 1964, and by counsel for respondents in two sections on March 24 and 31, 1964; and replies thereto were filed by counsel supporting the complaint on April 20, and by counsel for respondents on April 22, 1964.

Under Section 3.21 (a) of the Commission's Rules of Practice, this initial decision was due on March 17, 1964. Because of commitments in other matters, however, the hearing examiner was not

able to begin its study and preparation until March 31, 1964. For reasons set out in detail in his requests on February 3 and 18, and April 24, 1964, the hearing examiner requested extensions of time for filing this initial decision, first to June 1, and then to June 15, 1964. By its orders of February 10 and 24, and April 30, 1964, the Commission extended the time, first to May 1, then to May 15, and finally to May 25, 1964. This initial decision, accordingly, has been prepared and filed so as to meet that schedule.

After having considered the record in this proceeding, including the proposals and contentions of the parties, the hearing examiner issues this initial decision. Findings proposed by the parties which are not adopted herein, either in the form proposed or in substance, are rejected as not being supported by the record or as involving immaterial or unnecessary matter. All motions upon which rulings were reserved are hereby denied, except to the extent that the effect of the Findings of Fact and Conclusions herein may be to grant them in whole or in part.

The specific references herein to the testimony and exhibits, and to other parts of the record, are intended to be convenient guides to the principal items of evidence supporting findings of fact, and do not represent complete summaries of the evidence which was considered in such findings; and references to proposals of counsel are intended to include their references to the record in connection with such proposals. References to the record are made in parentheses, and the abbreviations used therein are intended to refer to parts of the record as indicated in the following list:

- Comp. — Complaint herein issued 6-5-63.
- Ans. — Answer to complaint by all respondents, filed 8-12-63.
- Tr. — Transcript of testimony.
- CB — Proposals and brief of counsel supporting the complaint, filed 3-23-64.
- CRB — Reply brief of counsel supporting the complaint, filed 4-20-64.
- RB — Proposed findings of fact of respondents, filed 3-31-64.
- RBL — Proposed conclusions of law of respondents, filed 3-31-64.
- RRB — Reply brief of respondents, filed 4-22-64.
- Fi. — Numbered paragraphs of the Findings of Fact herein.

FINDINGS OF FACT

The Carvel Organization

1. Respondent Carvel Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York. On August 2, 1946, its corporate name was changed from Dairy Whip Co., Inc., to its present name.

2. Respondent Dari-Freeze Stores, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York. It was originally incorporated under the name Carvel Dari-Freeze Stores, Inc., which on January 16, 1961 was changed to its present name.

3. Respondent Franchised Stores of New York, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York. On February 15, 1955, its corporate name was changed from Stramar Corporation to Carvel Stores of New York, Inc., and on January 16, 1961 to its present name.

4. Respondent Stores of Pennsylvania, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania. It was originally incorporated under the name Carvel Stores of Pennsylvania, Inc., which on April 7, 1961 was changed to its present name.

5. Respondent Dari-Freeze Stores of New Jersey, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New Jersey. It was originally incorporated under the name Carvel Dari-Freeze Stores of New Jersey, Inc., which on January 16, 1961 was changed to its present name.

6. Respondent Chain Locations of America, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York. On August 30, 1957, its corporate name was changed from Carvel Stores Realty Corp. to its present name.

7. Respondent Carvehicle Corp. (erroneously named in the complaint as Carvehicle Corporation) is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York.

8. The principal office and place of business of each of the respondent corporations is located at 430 Nepperhan Avenue, Yonkers, New York. Each of them performs specific functions in the operations of the Carvel organization, such as the production and sale or lease of machinery and equipment, contracting for the production and sale of ice cream mix, commissary goods and other products, licensing franchised dealers, and providing real estate sites for the location of franchised stores. For the purpose of this proceeding, however, it is unnecessary to define the particular functions of each, or to assess the responsibility of the several corporate respondents for the various acts and practices involved

in this proceeding. They operate as parts of a single, integrated enterprise under a common direction and control, and each of them contributes substantially to the aggregate results. The acts and practices of each of the respondent corporations are, accordingly, the acts and practices of all of them (CB 8-9). References herein to respondents or to Carvel are intended to refer to the respondent corporations severally and collectively, unless otherwise indicated.

9. Respondents Thomas Carvel, and his wife, Agnes Carvel, are individuals, and are the owners of the enterprise operated by the several corporate respondents (RB 1). They are also officers of certain of the respondent corporations. Thomas Carvel is the president, and Agnes Carvel is the treasurer of Carvel Corporation; they are the first vice president and treasurer, respectively, of Dari-Freeze Stores, Inc., Stores of Pennsylvania, Inc., and Dari-Freeze Stores of New Jersey, Inc; and they are the first vice president and assistant treasurer, respectively, of Franchised Stores of New York, Inc. (Ans., Par. 1).

10. Thomas Carvel is the active head of the Carvel organization and enterprise, and is the owner of various trademarks and design patents under which the corporate respondents operate as licensees (CB 8; RB 1). He formulates, directs and controls the acts and practices of the corporate respondents. Insofar as findings are made herein with respect to acts and practices of the corporate respondents, they are also the acts and practices of respondent Thomas Carvel, individually and in his official capacity; and any references herein to respondents or to Carvel are intended to include Thomas Carvel.

11. The record does not disclose that Agnes Carvel actively participated in the management or operations of the corporate respondents, and, insofar as there is evidence on this point, it is to the effect that she was inactive (Tr. 4799-4801). It is found, therefore, that she is and has been inactive, and that she has not personally participated in the acts and practices involved in this proceeding.

12. All of the ownership and interest of Thomas Carvel in the respondent corporations and in the trademarks and patents which they use, are, however, shared jointly by his wife, Agnes Carvel (RB 1; Tr. 3738). She contributed importantly to the beginning of their joint business enterprise, and for many years participated actively in its growth and development (Tr. 134-9), and she has been designated as an officer of certain of the respondent corporations. This is a closely held family enterprise in which Thomas

Carvel, with great flexibility, may function directly or through various corporate organizations, or, if necessary or desirable, through his wife. In these circumstances, the public interest requires that any order which may be entered herein should include Agnes Carvel as an individual and as an officer of certain of the respondent corporations.

13. Thomas Carvel went into the ice cream business in 1933 in Hartsdale, New York, with a truck and trailer, which was later developed into a store. He still operates a store on the same property as a pilot unit largely for the development of experimental products (Tr. 133-40). In 1938 or 1939 he began to work with the development of a small freezer designed to reduce refrigerating time required to freeze ice cream, and with the formulation of mix suitable for use in such freezers (Tr. 144-7, 151-2).

14. During the period from 1946 to 1949, his business was primarily manufacturing and selling freezers (Tr. 148), but, because of unsatisfactory operations by people who bought the freezers, it was necessary to repossess many of them (Tr. 147-50). In 1949 Carvel decided not to put in equipment unless it controlled the operation of the store, and began the development of the system of franchising retail dealers which is involved in this proceeding (Tr. 21, 147, 150), and which it has sometimes designated the "Carvel Franchise Systems" (Tr. 3120-1).

15. Since then Carvel has entered into franchise agreements by which it licensed dealers to operate roadside stands to dispense at retail to the consuming public ice cream and related products under the Carvel name and trademarks. The franchised dealers are also licensed to use the applicable Carvel patents, copyrights, procedures and authorized products.

16. In 1958 Carvel extended its operations to the manufacture of vehicles for dispensing, or manufacturing and dispensing, ice cream and related products. It sold such vehicles to new or existing dealers, and entered into "Vending Vehicles Franchise Agreements" with them (Tr. 3135-41; CX 157, 158).

17. Carvel also licensed in-town stores under its franchise system. These stores produced more flavors of ice cream from the same basic mix than the roadside stands and vehicles, and were permitted more latitude in the form in which they may serve the ice cream. After a number of franchises of these stores had been executed, a corporation was formed in May, 1960, under the name, 36-60, Inc. The outstanding franchises for the in-town stores were assigned to this corporation, and a somewhat modified form of

agreement was adopted for additional franchises of stores of this sort. Substantially all of the stock of 36-60, Inc., is owned by the individual respondents, Thomas and Agnes Carvel, and the 36-60 stores operate as a part of the Carvel franchise system (Tr. 3085-3134). Although 36-60, Inc., is not named as a respondent herein, the operations of the 36-60 stores are included for consideration as a part of the over-all activities of the respondents.

18. A New York corporation, Franchise Licensors, Inc., was organized on June 6, 1963, and its sole stockholder, who is not an individual respondent herein, has been connected with Carvel for the past twenty years (Tr. 263-6, 3168; CX 163-167). Its purpose was to supervise the operations of some of the franchised Carvel dealers whose activities and requirements presented certain difficulties to the regular Carvel management (Tr. 3169-72). A total of 35 Carvel franchises have been assigned to this corporation (Tr. 3160; CX 168). The assignment of the franchises resulted in no basic change in the operations or obligations of the affected dealers. Carvel receives 50% of the royalties paid by them, and is able to exercise final authority with respect to their renewal or termination as Carvel dealers (Tr. 3161-4). Although Franchise Licensors, Inc., is not named as a respondent herein, the operations of the Carvel dealers whose franchises were assigned to it, are included for consideration as a part of the over-all activities of the respondents.

19. Reference is also made in the record and in the proposals (CB 13-14) to another nonrespondent corporation which is a part of the Carvel franchise system. H-Burger Corporation, which was formed in 1959, licensed dealers to prepare and sell food products such as hamburgers, chicken, milk shakes, coffee and carbonated beverages, but not ice cream. Some of these dealers were also dealers under Carvel ice cream franchises, and, in such instances, the H-Burger premises were separated from the ice cream premises by a partition, or otherwise, so as to make a physical separation of the operations. The H-Burger dealers obtained their supplies essentially from Carvel, and certain of their supplies, such as milkshake mix, flavors and beverage concentrates, were the same as those supplied to dealers operating under the ice cream franchises. The operations of H. Burger Corporation are relevant to the considerations involved herein for the purpose of providing a fuller understanding of the nature and scope of the operations of the Carvel organization, as a whole, and with specific reference to its use of the same items supplied to other Carvel dealers.

The Carvel Operations and Restrictive Conditions

20. The primary charge is that through its franchise agreements Carvel requires its licensed dealers to purchase their entire supply of ice cream mix, commissary goods, and other products only from Carvel or from sources designated by Carvel (Comp., Par. 7(a)). It is also charged that Carvel precludes dealers from purchasing and selling products not authorized by it (Comp., Par. 7(b)), and forces them to purchase unnecessary or undesired equipment (Comp., Par. 7(c)). The other acts and practices challenged in the complaint are, in effect, alleged to be in furtherance of the foregoing restrictions upon the dealers, and involve inspection procedures, threats and coercion with respect to dealers (Comp., Par. 8); and restrictions upon and rebates from suppliers, and threats against non-designated suppliers (Comp., Par. 9).

21. There are now approximately 340 retail outlets, including roadside or "drive-in" stores, vehicles and 36-60 stores, licensed to make and sell ice cream and related products under the Carvel franchise agreements (Tr. 3174). Expressed in approximate percentages, 70% of those outlets are located in the State of New York; 16% in New Jersey; 7% in Connecticut; and 4.5% in Pennsylvania. The remainder is accounted for by 4 stores in Florida; 3 stores in Massachusetts; 1 store in Maryland; and 1 store in Wisconsin (RB 22). The great majority of the outlets are within a hundred mile radius of New York City (Tr. 23, 115). Carvel's total sales in 1959 amounted to approximately \$5,000,000 (Ans., Par. 4; also see Tr. 4802-3).

22. Carvel is actively engaged in seeking appropriate locations and establishing franchise operators. Typically, Carvel searches for available property in areas it considers suitable for the retail sale of ice cream (Tr. 115-6). By lease, purchase or otherwise, it acquires control of the property. Either with or without consultation and advice by the prospective operator, Carvel then erects a building of its characteristic design and dimensions, equips it to its specifications with signs, freezers, cabinets, lighting, sterilizing equipment, and other items, with provision for expansion, and sells the completed establishment ready for operation to a dealer under a franchise agreement. The dealer is trained in the Carvel method of operation, and is assisted in launching the business with an opening sale. He is then "on his own" (Tr. 23, 28-30, 37, 217-26, 245-6).

23. Under the franchise agreement, the dealer is required to purchase from Carvel, or from sources designated by Carvel, his

entire requirements of mix, toppings, flavors and other ingredients, cones and other items which constitute a part of the end product sold at retail to the consuming public. This requirement is clearly and specifically stated in the franchise agreement, and respondents require strict adherence to it by the dealers (CX 11, 170-174; CB 21; RB 14-16).

24. The dealer is also required to purchase and use only the manufacturing and dispensing freezer manufactured by Carvel (Tr. 226), and is encouraged to purchase his other equipment from Carvel. The dealer is given some latitude in purchasing equipment from other sources with the approval of Carvel (RB 14-16; RRB 53-56), but is closely supervised in the purchase and use of equipment from other sources (CB 22-28). Carvel's active discouragement of the practice results in relatively little equipment being purchased by dealers from other sources.

25. The dealers are retail manufacturers and dispensers of ice cream and ice cream products. They must be licensed as manufacturers by the local health authorities, and must operate in accord with local regulations with respect to sanitation under careful inspection by such authorities. It is apparent from the record that the regulations, requirements, inspections and corrective measures of local health authorities are adequate to assure that the dealers conform to appropriate sanitary standards, and dispense to the public products which are safe and sanitary. (See RB 71-3; RBL 35-8.)

26. The dealers are also required, by the terms of the franchise agreements, to operate in strict accord with standard operating procedures prescribed by Carvel, referred to herein as SOP. These procedures are incorporated in a manual which includes the specifications of the store and equipment, and which sets out in careful detail the method of operation. The manual covers not only the sanitation procedures which must be followed, but also the details of flavoring, freezing and dispensing the ice cream mix, and of manufacturing a variety of ice cream products from the basic mix. It specifies the ice cream products which may be manufactured and sold and the other products which may be sold, and the dealers are not permitted to manufacture or handle any products not specifically prescribed by the SOP (CX 11, 170-174; CB 32-35; RB 75).

The Carvel Products

27. The primary product sold by the dealers, and the one around which the Carvel operation is built, is ice cream dispensed, usually in a twist pattern (Tr. 45), directly from the freezer into

an edible cone or a paper cup, and served immediately to the consumer. It is dispensed and served at a sufficiently high temperature to be soft enough to flow from the freezer into the serving receptacle (RB 57). Its composition is such, however, that it retains its form in that relatively soft condition during the time ordinarily required for it to be consumed.

28. This product is described as "soft ice cream," or as "soft serve ice cream," and is comparable in appearance, texture and method of sale and service to products sold by others under various brand names. The term "soft ice cream" will be used generally herein to refer to the Carvel product described above and similar products sold by others. The more conventional form of commercially produced ice cream, which is hardened at much lower temperatures and sold to consumers either as a prepackaged product, or as a product which is "scooped" or "dipped" to individual orders, will be referred to herein generally as "hard ice cream."

29. Carvel's soft ice cream is also served to consumers as it comes from the freezer, with the addition of a variety of sundae toppings, such as syrup or fudge of various flavors, nuts and fruits. It is also used as it comes from the freezer in the preparation to individual orders of thick milk shakes, or "thick shakes".

30. The dealers also use the same ice cream in the manufacture of a variety of specialty items which are made up in advance and hardened at very low temperatures for future sale to consumers. These specialty items frequently are not consumed on the premises, and are commonly referred to as "take-home items." Also included in take-home items are prepackaged pints and quarts of soft ice cream which is drawn from the freezer into containers, and hardened at very low temperatures for future sale.

31. A Carvel dealer usually has two, or sometimes three freezers. He is accordingly able to serve only two or three flavors, which usually include vanilla and chocolate, directly from his freezers in the form of soft ice cream. During periods when he is not busy, however, he is able to utilize his freezers in the production of a large variety of flavors and specialty products for sale as take-home items. The products, after being hardened at very low temperatures in a "shock box," are held in a hardened condition at relatively low temperatures in display cases, and are sold to consumers in that form.

32. The hardened take-home items constitute a substantial part of the business of the Carvel dealers who operate roadside stands, and presumably also of the dealers who operate vehicles equipped

with freezers. The proportion of their sales of these items increases considerably during the colder months when the demand for soft ice cream directly from the freezer is relatively light (RB 58; RRB 12). The hardened items represent the entire business of the operators of vehicles which are not equipped with freezers, and the major part of the business of the 36-60 stores.

33. It is apparent, therefore, that, although the Carvel product is characteristically soft ice cream, it is also hardened for sale in the form of take-home items, and that the sale of such items constitutes a substantial part of the total sales of Carvel ice cream. Whether sold in its soft or hardened form, all the Carvel ice cream is made from the same basic mix (Tr. 48, 54).

Enforcement of Restrictive Conditions

34. Adherence by the dealers to the SOP, and particularly to the requirement with respect to purchasing from Carvel or sources approved by Carvel, is enforced by a system of inspection and control of the dealers' operations, reinforced by contract provisions and threats with respect to termination of the franchise, and by litigation or threats of litigation.

35. Franchise agreements were formerly for a period of 10 years, with a renewal provision for 10 years, and more recently they have been a period of 5 years, with a 5 years renewal provision (Tr. 115; CX 11). Breach by the dealer of any of the terms of the franchise agreements hereinabove referred to entitles Carvel to terminate the franchise, with liquidated damages against the dealer (CX 170, Pars. 4 and 17). Upon termination, the dealer is prohibited from engaging in the sale of frozen dairy products for a period of 5 years within 25 miles of the store he operated (CX 170, Par. 31).

36. The termination provisions of the franchise agreements are closely related to and made more effective by Carvel's control of the stores and the land on which they are located in the event the franchise should be terminated. Typically, the real estate on which the Carvel store is erected is owned or leased by Carvel. When the completed and equipped store is sold to a dealer under a franchise agreement, the lease is assigned to the dealer (CX 4), with a conditional reassignment to Carvel, which may become effective upon breach of any of the terms of the franchise agreement, among other things (CX 5). In at least one instance a dealer who owned the property was required to lease it to Carvel (CX 13), with an assignment back to the dealer (CX 14), and a conditional reassignment to Carvel (CX 15).

37. In the event of the termination of a franchise, Carvel also has the right to purchase all of the dealer's machinery and equipment in the store at a depreciation of its original cost of 50% during the first year, with further depreciation in later years (CX 5, Par. 3a). Signs and certain special equipment covered by patents are leased to the dealer by Carvel at the nominal rental of \$12 per year under an agreement which terminates with the franchise (Tr. 119, 217-9; CX 6).

38. Dealers make very substantial investments in their stores, the record disclosing instances in which such investments amounted to sums ranging from \$20,000 to \$70,000 (Tr. 1518, 2056). The termination or threatened termination of a franchise, with the resulting loss by the dealer of his store and investment, and the curtailment of his rights to engage in a similar business, is, accordingly, a powerful tool in enforcing the terms of the agreement. (See RBL 38-42.)

39. The franchise agreement authorizes Carvel to inspect the store records and operations of the dealer at such times as it desires (CX 170, Par. 5). Carvel employs about 6 supervisors who inspect the stores and make detailed reports concerning violations of the SOP. They are particularly alert to detect and report the use of "substitute" or "unauthorized" products, and the books of the operator are sometimes audited to discover the use of such products. The inspections generally are irregular and infrequent, but, where substitutions are found, the inspections are frequent and persistent until the situation is corrected. Where necessary, the inspection reports result in communications from the Carvel headquarters, and in action by its legal department (Tr. 97-104).

40. The record contains convincing evidence of instances in which Carvel policed the operations of dealers with respect to the sale of unauthorized products and the use of commissary items obtained from sources other than Carvel. It also contains evidence of policing with respect to the use of equipment obtained from other sources, even though the dealers are granted some latitude with respect to equipment. Carvel has insisted that the use of such items and equipment be discontinued, and to this end has threatened to employ the sanctions of franchise termination and legal action. (See CB 32-47; RRB 69-72.)

41. Companies which manufacture and sell commissary and other items under contract with Carvel refrain from selling such items directly to the Carvel dealers, and from competing with Carvel and its other suppliers in attempting to sell other items which they

produce to the dealers (CB 69-70). Manufacturers not under contract with Carvel, who have sold to Carvel dealers, are cautioned to discontinue doing so, and are threatened with legal action if they persist (Tr. 105-6; CB 73-75).

42. Carvel's policing activities have been vigorous and effective, and threats and coercion have been freely employed when needed. Active solicitation of its dealers by Carvel's competitors has been almost wholly eliminated (CB 72), and substantially the only purchases by Carvel dealers from such competitors are made under clandestine circumstances (CB 73), or to meet emergency requirements.

Royalties and Profits

43. Royalties are paid to Carvel by the dealers for the right to use the Carvel name, forms and techniques. Such royalties are based primarily upon the quantity of ice cream mix used by the dealers, and the amount of the royalty has varied over the years from 10¢ to the present minimum level of 25¢ per gallon, subject to increases geared to the Bureau of Labor Statistics Consumers Price Index (Tr. 181; CX 170, Par. 7). Converted to the delivery unit in use, the royalty currently amounts to \$2.50 to \$2.80 per 10 gallon can (Tr. 62). Substantially the same mix in a different concentration is also sold to a few of the dealers who have machines for the production of thick shakes. This is referred to as thick shake mix, and the royalty on it is half the royalty on ice cream mix (Tr. 124-6).

44. Largely for the purpose of discouraging the purchase of mix from other sources by making it economically necessary to concentrate with Carvel, the franchise contracts with dealers now provide for a minimum royalty of \$2,000 per year, and franchise renewals provide for a minimum royalty based upon the second best year of the dealer's operations (Tr. 185-6, 252-3). In addition to their payments of royalties on ice cream mix, the dealers are now assessed 1% of their gross sales as a contribution to Carvel's advertising fund (Tr. 161, 252, 896).

45. Ice cream mix supplied to Carvel dealers is manufactured by dairies under contracts with Carvel according to Carvel's formulas and specifications (CX 97, 107, 120). The dairies producing the mix are located in the several local areas near the Carvel stores, and deliveries are made directly to the stores by the dairies. At the present time two dairies supply the stores in the New York City and Long Island area, and elsewhere only one dairy supplies the stores in each particular area (Tr. 57-61).

46. The ice cream mix is sold by Carvel to the dealers at a price which currently is 75¢ per 10 gallon can higher than the price at which it is sold by the dairy to Carvel (Tr. 2111, 2161; CX 98, 100-105). The mix is delivered directly to the dealers by the dairies upon the orders of the dealers, and collections are made by the dairies from the dealers at the prices to the dealers established by Carvel plus the royalty (Tr. 2069-70, 2140). The dairies have accounted to Carvel for their collections from the dealers in various ways, but the sale is essentially by the dairies to Carvel, and by Carvel to the dealers, with deliveries and collections being made by the dairies on behalf of Carvel. (See RB 65.)

47. Ice cream mix is made in accord with a secret formula supplied to the dairies by Carvel. The ingredient contributing primarily to the secrecy of the formula is a combination emulsifier-stabilizer used for the purpose of making homogeneous a combination of solids and liquids. It is "a basic product in making the mix," and is made in accord with a secret formula developed by Carvel for its particular purposes. It is manufactured only for Carvel, and is sold to no one else by the manufacturer (Tr. 74-5). It is sold to Carvel by the manufacturer at approximately 63¢ per pound (Tr. 2615-19; CX 126), and is supplied to the dairies by Carvel at 76¢ per pound (Tr. 2109).

48. In about 1960, Carvel added ices and sherbets to its line, which were sold and delivered to the dealers already frozen and ready for resale in prepackaged form and by scooping (Tr. 465-6, 1953-7; CX 90, 91, 92). In 1963 these items were eliminated, and Carvel added sherbet mix to its line. This mix is used by the dealers for the manufacture and sale of sherbet in much the same manner as the procedures with respect to ice cream mix. The sherbet mix is produced and supplied to the dealers by the same dairies supplying the ice cream mix. Although the price of the sherbet mix is considerably less than that of the ice cream mix, it is sold to the dealers by Carvel at the same markup per 10 gallon can, and the same royalty applies (Tr. 1801-4, 1957-75, 2161; CX 93, 105).

49. The toppings, flavors and other ingredients incorporated in the ice cream manufactured by the dealers are referred to generally as commissary items (CX 10). Many of these items are produced under formulas developed by Carvel, and are manufactured by various companies for Carvel to its specifications (Tr. 62-3, 191-209). Other commissary items regularly produced by the manufacturers are modified or adapted in certain respects to meet the

Carvel requirements and specifications (Tr. 231-42). All of these items are packaged for Carvel under its trade name.

50. The commissary items, excluding mix, are, with minor exceptions, purchased and warehoused by Carvel (Tr. 65), and sold and delivered by it to the dealers. No royalty is paid by the dealers on these items (Tr. 67), but they are sold to the dealers at prices higher than the prices paid by Carvel, in some instances the margin being very substantial (Tr. 3186-7, 3707-20, 4112-24; CX 176; RX 146; see CB 50; RB 66).

51. Ice cream cones are purchased by Carvel from two manufacturers (Tr. 1108, 1166), and are resold by Carvel to the dealers at a margin reflecting the usual difference between the price to jobbers and to retail manufacturers of ice cream (Tr. 1172-82). They are delivered directly to the Carvel dealers by the manufacturers. Payments are made by the dealers to Carvel, and by Carvel to the manufacturers (Tr. 1109-12, 1164-5, 1168-72; CX 40, 41).

52. The cones involve certain distinctive features (Tr. 73), and are identified with the Carvel name on the cartons in which they are delivered to the dealers (Tr. 1104-6, 1158-9, 1167-8). Certain types of the cones are also identified with a private brand, "Major" (Tr. 1102, 1116, 1154), and others are in individual paper wrappers marked with the Carvel name (Tr. 1103, 1154-5, 1163-4).

53. All of the freezers, mix, cones and commissary items which the dealers are required to purchase only from Carvel, or sources designated by Carvel, are sold to the dealers at prices reflecting a margin of gross profit to Carvel. A basic ingredient of the mix is sold by Carvel to the dairies at a price higher than its cost to Carvel, and royalty payments are made by the dealers to Carvel on the mix. A margin of gross profit is also included in any sales of equipment by Carvel to the dealers (RBL 48-9; RRB 60-68). Sales of these items to the dealers constitute an important part of the Carvel revenue which would be seriously impaired if the dealers were permitted to purchase from other sources. The profit motive is, accordingly, a significant factor in Carvel's insistence that the dealers purchase such items only from it, and that they refrain from dealing in unauthorized items.

54. In connection with the restrictions upon products and methods of operations, Carvel has developed different categories of franchises for specific purposes, such as vehicle dispensing, 36-60 stores, and H-Burger stores. In this way it has increased the number of franchises, and its revenue from the sale of franchise opera-

tions, in a particular area. (See CB 54-57.) There are also in evidence instances in which the leasing and subleasing of the property on which the stores are located has constituted a source of revenue to Carvel. (See CB 57-59.)

The Carvel Franchises are Tying Agreements

55. It is apparent from the foregoing that Carvel's franchise agreements, and its operations under them, effectively prevent its dealers from purchasing freezers, mix, cones and commissary items generally from sources other than Carvel, and impose substantial restraints upon its dealers in purchasing other equipment and items. The restraints are clear, specific and effective. It remains to be determined whether or not they may be of such character and consequence as to constitute unfair methods of competition within the meaning of Section 5 of the Federal Trade Commission Act, and, if so, whether or not they are justified as a business necessity.

56. The Carvel franchise system is founded upon the use of the Carvel name, insignia, designs, procedures, supervision and services. Under the franchise agreement, a fully equipped store, ready to operate, is leased, and its equipment is sold, to the dealer. He is trained in the Carvel method of operation, and is supplied with detailed guides covering the procedures to be followed and the method of producing and dispensing approved items, and he is afforded such supervision and guidance as needed in the operation of the store. The dealer is licensed to use the Carvel name, products, and techniques, including copyrights and certain patented equipment, some of which is leased to him.

57. These are undoubtedly valuable rights and services (RB 68-9; RRB 50-3), which may be obtained only upon carefully defined terms and conditions. In return for them, the dealers make substantial initial investments, and undertake the obligations to Carvel discussed above. Upon breach of these obligations, the dealers are subject to the termination of all their rights under the franchise, the surrender of their stores and equipment at a fraction of their investment, and sharp limitations upon their right to engage in a similar business.

58. The Carvel franchises are, accordingly, agreements which tie the purchase of equipment, ice cream mix and commissary items to leases and licenses to use the Carvel name, copyrights, patents, products and techniques. They are "tying agreements," and are therefore, unreasonable if Carvel "has sufficient economic power with respect to the tying product to appreciably restrain free com-

petition in the market for the tied product and a 'not insubstantial' amount of interstate commerce is affected." (*Northern Pac. R. Co. v. U.S.*, 356 U.S. 1, at 6.)

59. From modest beginnings in the ice cream business in 1933, respondent Thomas Carvel began, in 1949, the system of franchising dealers which now includes 340 retail outlets, located primarily within a hundred mile radius of New York City. In 1959 Carvel's total sales amounted to approximately \$5,000,000 (Fi. 13, 14, 21), and it is clear that its operations are in a continuing condition of growth and development (CB 18). Its potential for development in other areas is illustrated by its accomplishments in the New York City area where its outlets are now primarily concentrated (*infra*).

60. The "tying product" is the Carvel franchise, by virtue of which Carvel has absolute power to require, and does require, its dealers to purchase the tied products, particularly freezers, mix, cones and commissary items, only from it. The franchise is, accordingly, "an effectual weapon to pressure buyers into taking the tied item," and it was used to induce its 340 retail outlets "to give it preference, to the exclusion of its competitors," in purchasing the tied items. (*Northern Pac. R. Co. v. U.S.*, *supra*, at 6 and 7.)

Economic and Competitive Substantiality

61. The record discloses that others are engaged in supplying mix and other items to retail dealers in the metropolitan New York area, who manufacture and dispense soft ice cream, and that there are many such dealers in the area in addition to the Carvel dealers (RRB 14-18). The record does not disclose, however, on what terms and conditions these non-Carvel dealers are supplied, nor does it disclose what proportion of soft ice cream dealers in that area is represented by Carvel dealers.

62. The record discloses that the suppliers of particular commissary items to Carvel refrain from competing with it by attempting to sell other items which they produce to the Carvel dealers. It also discloses that other producers of commissary items in position to compete for the business of the Carvel dealers, and who consider them to be highly desirable accounts because of their volume of purchases, are foreclosed from doing so by Carvel's restrictions upon its dealers, and its cautions to, and threats of legal action against, its competitors (Fi. 41-42; CB 68-75).

63. That the Carvel dealers are highly desirable accounts is fully established by the record. It is also forcefully emphasized by the statement of Thomas Carvel that "We do the largest dollar

volume in the east per unit in our stores" (Tr. 101). No effort was made by complaint counsel, however, to determine the market share of Carvel with respect to any commissary items, excluding mix.

64. Ice cream mix is the only item sold by Carvel to its dealers with respect to which counsel supporting the complaint endeavored to show Carvel's share of the market. This effort was limited to the single area represented by New York City and Nassau and Suffolk Counties on Long Island, and to "soft ice cream mix," which counsel supporting the complaint contend represent an appropriate geographic area and product line.

65. Of the total of approximately 340 Carvel retail outlets, 180 are located in New York City and Nassau and Suffolk Counties on Long Island (CB 65). One of the dairies, from which Carvel purchases ice cream mix, delivers the mix to Carvel stores located throughout this area. This is the only area in which that dairy sells ice cream mix to anyone (Tr. 2190, 2225-6), and until recently it was the only dairy delivering mix to Carvel dealers in this area (Tr. 3230-1). This is a large, and well-defined metropolitan and suburban area, which includes the largest concentration of Carvel dealers. It is an appropriate area in which to examine Carvel's market position and the possible competitive effects of its restrictive conditions. (See CB 97-99; CRB 29-34.)

66. There are many formulas for the mix used in the manufacture of soft ice cream (RB 55-56), but, because of the method of manufacturing and serving the product by retail dealers, they must necessarily have certain common characteristics which differ in important respects from the mix used in the manufacture of hard ice cream. Mix with these characteristics is commonly referred to as soft ice cream mix (Fi. 27-28).

67. Soft ice cream is produced in relatively small freezers in which the mix is agitated as it passes through, frozen in a very short time, and ejected from the front nozzle. It is ejected in a form firm enough to hold its shape, at the relatively high temperature of 18 to 22 degrees, long enough to be consumed (RB 55-57). As it is agitated and frozen, air is incorporated in the mix so that its volume is increased about 40% to 50%, which increase is referred to as "overrun" (RB 60). Ordinarily, when soft ice cream, after being drawn from the freezer, is hardened at low temperatures and stored for a prolonged period, its texture may be impaired by a form of crystallization or "sandiness" (RB 57, 59).

68. Hard ice cream is commercially produced in larger freezers, agitated differently, and drawn from the freezer at about 27 de-

grees, in a form in which it will flow so as to assume the shape of the container and level itself. As it is agitated and frozen, a greater proportion of air is incorporated in it so that its volume is approximately doubled, resulting in an overrun of about 80% to 100% (RB 60). It is then frozen into a hard form at very low temperatures and may be stored for very long periods without deterioration.

69. The characteristic differences between hard and soft ice cream require significant differences in the formulation of the mix used to produce them. Because of the difference in agitation, soft ice cream mix, which contains butterfat in excess of 10% or 12%, will "butter out" and develop a grainy texture, but hard ice cream mix may contain butterfat up to 18% (CB 61). Soft ice cream mix requires an ingredient, referred to as an emulsifier and stabilizer, which will give the ice cream a smooth body and texture and enable it to hold its shape so that it can be served as it comes from the freezer; while the mix for hard ice cream requires a different type of emulsifier-stabilizer which will enable it to resist prolonged storage at low temperatures without deterioration (CB 61-2). Because of the lower overrun of soft ice cream, its mix requires less sweetener (CB 62). Under properly controlled conditions, soft ice cream can be hardened for later use (CB 62-3), but hard ice cream mix cannot be successfully used to produce soft ice cream (Tr. 2282-3; RB 57).

70. Dairies, engaged in the production and sale of ice cream mix, ordinarily produce and distribute both types. The difference in formulation is such that both types may be readily produced by dairies properly equipped for the production of ice cream mix. The same dairy frequently produces both types under many different formulas, and it is not uncommon for dairies to produce either type in accordance with special and secret formulas supplied by their customers (RB 55-6). Each type is produced by the dairies, however, for a particular class of customers, and they rarely sell both types to the same customer.

71. Soft ice cream is produced by retailers with specialized freezing and dispensing equipment, and with facilities designed to serve a particular class of customers. These retailers are represented primarily by dealers operating roadside stands and mobile dispensing units who do not provide seating facilities for their customers. Hard ice cream is produced commercially by large wholesale manufacturers, and by retailers operating such establishments as hotels, confectionery stores, and "ice cream parlors" where it is served primarily by dipping or scooping (CB 63). In actual

practice, therefore, soft ice cream mix is a special type of mix which is sold to a specialized and clearly defined category of customers. (See also Tr. 3078.)

72. Roadside stands and mobile dispensing units selling soft ice cream frequently operate in proximity to retailers selling hard ice cream, and there is obviously competition between them in selling soft and hard ice cream to the consumer. Because of their specialized equipment, facilities and product, however, the retailers of soft ice cream primarily attract the "drive-in" and "stand-up" trade, and their locations are usually selected so as to facilitate the patronage of that class of customers. Direct competition between the retailers of soft and hard ice cream is, accordingly, sharply limited.

73. Respondents urge with great earnestness that Carvel ice cream mix, which is made in accordance with its own secret formula, is unique, and that it incorporates special characteristics which are not present in any other ice cream mix, either hard or soft. It is urged, particularly, that it is a "dual purpose mix" which will produce a smooth, soft ice cream which, when served directly from the freezer, will hold its form, and which may be hardened at very low temperatures for later sale without impairing its quality (RB 54-64; RBL 27; RRB 50). Carvel ice cream mix, however, has the essential characteristics of soft ice cream mix, and it is produced for and sold only to the class of trade which deals in soft ice cream. It is, therefore, properly classified as soft ice cream mix.

74. Respondents contend that the product lines involved in this proceeding are ice cream mix and ice cream products. They urge that there is sufficient cross-elasticity of demand for soft and hard ice cream to make it improper to consider the substantiality of the effects of the challenged practices with respect only to soft ice cream mix and products (RRB 11-13). In view of the considerations discussed above, however, it is the opinion of the hearing examiner that soft ice cream mix is sufficiently distinct in its characteristics and channels of distribution to be an appropriate product line for consideration in this proceeding.

75. Sales of soft ice cream mix by Carvel to its dealers in the New York City-Nassau-Suffolk area amounted to 856,660 gallons in 1960, 957,820 gallons in 1961, and 1,047,440 gallons in 1962. All of this mix was supplied and delivered to the dealers by a single dairy under contract with Carvel (Tr. 2185-2205, 2221-3; CX 107, 109).

76. Representatives of nine dairies which sell ice cream mix in the same area in competition with the dairy supplying the Carvel dealers testified in this proceeding (CB 66; RRB 13). These dairies

regard the Carvel dealers in that area as significant outlets for soft ice cream mix, and as very desirable accounts. They desire to compete for the business of those dealers, but are effectively precluded from doing so by the restrictive conditions under which the dealers operate, and Carvel's enforcement of those conditions (CB 66-7).

77. Complaint counsel contend that the evidence adduced through these witnesses discloses that the total sales of soft ice cream mix in the area in 1962 amounted to 2,779,981 gallons, and, accordingly, that Carvel's share of the market amounted to 37.7% (CB 67 and Appendix Tables A, B and C). Respondents, however, discuss in some detail what they consider to be important omissions and deficiencies in the data with respect to total sales of soft ice cream mix in that area (RRB 13-16).

78. It appears that the sales figures of at least one of the witnesses may have included an undetermined amount of mix other than soft ice cream mix (Tr. 2640-4, 2656; CX 127; RRB 16). To the extent that a different type of mix was included in the figures by this witness, it serves only to inflate the total figures with respect to soft ice cream mix and to deflate Carvel's market position. The inclusion of mix other than soft ice cream mix in the figures, therefore, does not prejudice the respondents' position with respect to this point.

79. There is some evidence, however, that the total figures compiled by complaint counsel do not include the sales of certain dairies which may be selling soft ice cream mix (Tr. 2774-5, 3044; RRB 13). From the testimony referred to, and the testimony of the other witnesses as a whole, however, it is inferred that these apparent omissions were of dairies whose production and sale of soft ice cream mix in the market area involved were not sufficiently substantial to impress their competitors.

80. It is the opinion of the hearing examiner that the total figures with respect to sales of soft ice cream mix in the New York City-Nassau-Suffolk area cannot be accepted as being precisely accurate, but that they may be accepted as substantially correct for the purpose of indicating the approximate dimensions of Carvel's market position in this area. Although these figures cannot be accepted as accurately reflecting that Carvel's sales represent 37.7% of the market, they nevertheless persuasively indicate that its share of the soft ice cream mix market in this area is very substantial and impressive.

81. Respondents contend that statistical information from official sources shows that Carvel's share of the ice cream mix business in the relevant market is 5% or less (RRB 20-22). For the purpose

of this contention, they request that official notice be taken of certain statistics of the U.S. Department of Agriculture with respect to the Dairy Industry in New York State (RRB 20). Complaint counsel, on April 27, 1964, filed answer in opposition to this request to take official notice; respondents, on May 18, 1964, filed a reply thereto in justification of the requested official notice; and complaint counsel, on May 19, 1964, filed a motion to strike respondents' reply of May 18. Because the hearing examiner considers soft ice cream mix to be an appropriate product line for consideration in this proceeding, and because complaint counsel have had no opportunity to disprove the reliability of the statistics for the purpose for which they are offered (Section 3.14(d) of the Commission's Rules), the request for official notice is denied. Because a full exposition of respondents' position should be available for the consideration of any reviewing authority, the motion to strike respondents' pleading of May 18 is also denied.

82. It should be noted, however, that, even on the basis of respondents' contentions concerning Carvel's share of the market, it is apparent that the economic effects of its restrictive conditions are not insubstantial. Respondents contend that the appropriate product line for consideration is ice cream mix, including mix for the production of hard and soft ice cream (RRB 11-13). Applying the statistics for which they request official notice to this product line, respondents contend that Carvel's share of the market in the New York City-Nassau-Suffolk area in 1960 was 4.01%; that in 1961 it was 4.25%; and that in 1962 it was 4.70% (RRB 20-22).

83. In a recent decision, it was held that control of 3.4% of the service stations, and the sale of 2.5% of the gasoline sold in the United States, together with large dollar volumes of sales of other products in the service stations, demonstrated that the company involved "has sufficient economic power in the gasoline market to restrain a substantial amount of commerce" in the sale of such other products in service stations (*The Atlantic Refining Company, v. F.T.C.*, 331 F. 2d 394, April 24, 1964). Although the factual situation here is different in certain respects, it involves a striking parallel which appears to be governed by the same legal principle. It is the opinion of the hearing examiner that, if the facts disclosed that Carvel sells more than 4% of the total ice cream mix in the relevant market area in which it controls 180 choice retail outlets, they would demonstrate that it has sufficient economic power in the ice cream mix market to restrain a substantial amount of commerce.

Interstate Commerce

84. Respondents contend that Carvel's shares of the markets in the five States of Connecticut, Massachusetts, Pennsylvania, New Jersey and New York are of minimal proportions (RRB 23); that the market area of New York City-Nassau-Suffolk involves the sale of ice cream mix by Carvel only in intrastate commerce (RRB 27); that 70% of Carvel's gross annual business of approximately \$5,000,000 is within the State of New York (RB 28-9); and that there is no substantial evidence that suppliers competing with Carvel were engaged in the interstate commerce to a substantial degree (RBL 4-16).

85. The principal office and place of business of the respondents is located in Yonkers, New York. Carvel has manufacturing facilities also located in Yonkers, where it produces, and from which it delivers, much of the equipment sold to its dealers (Tr. 31-4). Commissary items and other supplies purchased by Carvel from sources in various States come into its warehouse in New York, from which they are delivered to its dealers (Tr. 64-6). Dealers to which Carvel makes sales and deliveries, from its New York facilities are located in New York, New Jersey, Connecticut, Pennsylvania, Florida, Massachusetts, Maryland, and Wisconsin (RB 22), and it engages in advertising by radio, television, newspapers and circulars, much of which crosses State lines (Tr. 34-5). Carvel is, accordingly, extensively engaged in interstate commerce.

86. Ice Cream mix supplied to Carvel dealers is delivered to them by dairies located in the several local areas near the dealers, and these deliveries cross State lines only to a very limited extent. All of the ice cream mix supplied to the Carvel dealers in the New York City-Nassau-Suffolk area was delivered from locations in New York, and the evidence with respect to Carvel's share of the mix market in that area is based upon intrastate deliveries of mix. The same restrictive conditions, however, apply to all Carvel dealers, including some who receive interstate deliveries of mix, and many who receive interstate deliveries of commissary and other items from Carvel.

87. The highest concentration of Carvel retail outlets is in the New York City-Nassau-Suffolk area, and the principal product supplied to the dealers under the restrictive conditions is ice cream mix. The concentration of Carvel outlets in other areas and in other States is at this time very limited. It is quite obvious, therefore, that the possible competitive impact of the challenged practices can be most effectively demonstrated with respect to the selected

area and product. It is also quite doubtful that an impressive demonstration could be made at this time with respect to other areas.

88. The evidence has clearly demonstrated the capacity and tendency of the restrictive practices to lessen competition in the intrastate area. This relates to the practices and the manner in which they are employed, and the area involved in the demonstration is only incidental. The demonstrated capacity and tendency are inherent in the practices wherever they may be used. If the same demonstration were made with respect to an interstate area, it seems clear that the scope of an effective remedy would necessarily enjoin the use of the same practices in all areas within the Commission's jurisdiction.

89. The practices are challenged as unfair methods of competition and unfair acts and practices in interstate commerce in violation of Section 5 of the Federal Trade Commission Act. The use of unfair practices in interstate commerce is unlawful, and the fact that proof of their capacity and tendency substantially to restrain trade relates to an intrastate area, does not lessen the impressiveness of the showing. It is important, in the public interest, to stop in their incipiency the use of proven unfair acts and practices in areas where they may not have reached Sherman or Clayton Act proportions. (See *F.T.C. v. Motion Picture Ad. Service Co., Inc.*, 344 U.S. 392, at 394-5, and cases there cited. Also see discussion in CRB 23-28.)

90. It is the opinion of the hearing examiner, therefore, that the evidence of the possible competitive effects of the challenged practices in the selected intrastate area, and with respect to a single product line, has established that those practices have the capacity and tendency substantially to lessen competition. This capacity and tendency exists not only in the selected area and with respect to the selected product, but also in other areas in which Carvel operates, and with respect to other products which it sells under the restrictive conditions. Carvel uses these practices in interstate commerce, and such use should be restrained unless justified by other considerations.

Business and Economic Necessity

91. Respondents contend that the restrictive provisions of their franchise agreements, and their inspection and enforcement procedures, represent what they must and may legally do as a business and economic necessity to protect the Carvel trademarks, and to protect the dealers and consuming public in the sale and purchase

of highly perishable products for human consumption under regulations with regard to sanitation and health (RB 68-75). They distinguish their situation from one involving the marketing of "shoelaces or pickles" (RRB 3). Their contentions with respect to business and economic necessity involve a number of facets warranting separate examination.

92. It is urged that the inspection and supervisory activities of respondents are necessary in order to be sure that appropriate health and sanitary standards are observed by the dealers and to accomplish conformity with applicable laws and regulations with respect thereto (RB 71-3; RBL 35-8). It is apparent from the record that the regulations, requirements, inspections and corrective measures of local health authorities are adequate to assure that the dealers conform to appropriate sanitary standards, and dispense to the public products which are safe and sanitary (Fi. 25).

93. Even so, however, it is appropriate for Carvel to undertake procedures of its own to see that dealers using its trade name comply with applicable health and sanitary regulations so as to protect the public and its own good will. Such procedures are not challenged herein insofar as they seek to accomplish these legitimate ends, but are challenged only to the extent that their use is ancillary to the enforcement of Carvel's restrictive conditions. Carvel's inspections have been much more frequent, and its requirements with respect to health and sanitation have been much more severe in connection with dealers who violated its restrictive conditions than with others (Fi. 39-42). The record leaves no doubt that, in addition to their legitimate purposes, these procedures have been used to facilitate the enforcement of Carvel's restrictive conditions upon its dealers.

94. Respondents urge that their inspection and supervisory activities were also necessary to protect Carvel's rights of trademark and to prevent or terminate trademark infringement, particularly by selling non-Carvel products under the Carvel name (RB 74-75; RBL 16-24). They recognize, however, as they necessarily must, that a system of distribution "which discloses a purpose to subvert the antitrust laws or Section 5 of the Federal Trade Commission Act, can gain no immunity based on the perishable nature of the commodities or any secret process by which they are made, or by virtue of the fact that they are sold under established tradenames or trademarks." (RRB 2-3.)

95. They argue, however, that, in the circumstances here presented, the antitrust implications of Carvel's methods of competi-

tion must be evaluated by the rule of reason (RBL 25). Based upon this conception, they cite a number of cases in which they argue that "Business steps for business reasons, having a reasonable economic basis and not associated with any plan or purpose to monopolize, fix prices, injure competitors and restrain interstate commerce were held sufficient to defeat charges that exclusive dealing contracts violated the antitrust laws" (RBL 26).

96. The stated principle does not apply to the present situation. The record in this proceeding convincingly establishes that the exclusive dealing requirements of Carvel's tying agreements with its dealers are associated with a plan and purpose to restrain interstate commerce by isolating from the competitive arena, and channeling to Carvel alone, the entire purchases of the tied products by its dealers. Others are foreclosed from competing with Carvel in selling such products to its dealers, and the dealers, as independent businessmen, are denied the advantages historically attributed to such competition.

97. The use of special formulas for promoting increased business and profits and for inducing customer acceptance of the Carvel products constitutes an important aspect of the business necessity urged by respondents for Carvel's method of doing business (RBL 25). They contend that the publication of specifications for ingredients other than mix would create insuperable obstacles to quality control, by providing unpreventable and undiscoverable opportunities for the substitution of inferior ingredients (RBL 29-30). In this connection, they cite the following language of the Supreme Court in *Standard Oil v. U.S.*, 337 U.S. 293, at 306 (RBL 30):

The only situation, indeed, in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied.

98. Respondents argue that the special and secret formula for Carvel ice cream mix "achieves novel and functional product improvement of great value," emphasizing its utility as a "dual purpose" mix for the production of soft ice cream which may be hardened without impairment of its quality (RBL 27; also see Fi. 33, 73). Insofar as Carvel's mix may be superior in this respect to other mix used in producing soft ice cream, such superiority is due primarily to the emulsifier-stabilizer which the dairies are required to use in its production (Tr. 74-6, 80-8, 150-1, 3215-19). This emulsifier-stabilizer is made for Carvel by a manufacturer of such products in accord with Carvel's secret formula (Fi. 47), and the

manufacturer of this ingredient has been changed from time to time (Tr. 3193-5).

99. Respondents contend that the Carvel franchising system affords important benefits and advantages to the dealers (RB 68-9). For these benefits and advantages to be fully utilized, it is urged that it is necessary for the dealers to obtain the ingredients going into the end product from the same source in order to achieve uniformity and consumer acceptance, and that this result could not be accomplished by providing detailed specifications to be used by various suppliers (RB 69-71; RBL 24-35).

100. Carvel's ice cream mix is produced for it by various dairies in accordance with its specifications and secret formula; and the emulsifier-stabilizer ingredient of the mix supplied to those dairies by Carvel is manufactured for Carvel to its specifications. The toppings, flavors and other ingredients incorporated in the end product are also manufactured for Carvel according to its specifications (Fi. 49), and the manufacturers of the products have been changed by Carvel from time to time as circumstances in its judgment warranted. (See CRB 57-59.)

101. The Carvel system envisions, and is founded upon, extensive and minute specifications by Carvel of all of the details of the operations of its dealers. These specifications include the details of store operations, the handling of the mix, the addition of flavors to it, the freezing and serving processes, and the production of a wide variety of specialty ice cream products, and their storage, display and method of sale.

102. The Carvel dealers are in fact retail manufacturers of soft ice cream and products made from it. The mix delivered to them is unflavored. Starting with that neutral mix, the dealer manufactures a variety of end products, using Carvel ingredients and Carvel techniques. Obviously, in operations such as these by many dealers with varying experience, capacities and ideas, there are considerable opportunities for material variations in the end products, and a strong likelihood that such variations will occur. (See CRB 53-57.) This is a problem, however, which Carvel has handled under its present system, including its training, supervisory and inspection procedures, through which it has apparently been able to achieve what it considers to be a satisfactory degree of uniformity in the end products.

103. The record discloses that the production of particular ingredients by different manufacturers, even in accordance with Carvel's specifications, would result in problems with respect to

uniformity (RB 69-71). It seems obvious, however, that established manufacturers, skilled in their fields, are able to produce particular ingredients, within the scope of their specialties, so as to meet Carvel's standards and specifications with a relatively high degree of consistency. Their production from Carvel's specifications of the several specialized ingredients should result in a materially greater degree of uniformity than can be achieved by the dealers in manufacturing the end products from Carvel's specifications even with the use of identical ingredients.

104. Carvel's history of dealing with various manufacturers of the ingredients which it sells to its dealers, and of changing them from time to time, has clearly demonstrated that compliance with its specifications is not an insuperable problem, or one of such magnitude as to involve undue difficulties in the practical administration of Carvel's operations.

105. The benefits and advantages of the Carvel franchising system to the dealers are, undoubtedly, important and valuable in many respects. This is what makes the Carvel franchise attractive to the dealer, and what makes the prospect of its termination an effective disciplinary tool. The protection of its good will, and the public acceptance of its products wherever they may be sold, are also considerations of great importance and value both to Carvel and to its dealers. The record discloses, however, that the specifications for ingredients which will meet the standards and quality required by Carvel, would not be so detailed that they could not practicably be supplied.

106. The protection of the good will and public acceptance of Carvel's products, accordingly, does not necessitate the use of the exclusive tying conditions of Carvel's franchising system. Carvel's trade name cannot be used as a device to justify practices which unreasonably restrain trade (*Timken Co. v. U.S.*, 341 U.S. 593, at 598-9), and respondents concede that the use of secret formulas confers no special immunity for antitrust conduct (RBL 25).

(In arriving at the foregoing results, the hearing examiner is not unmindful of the decision of the United States Court of Appeals for the Second Circuit on May 8, 1964, in *Bernard Susser, et al. v. Carvel Corporation, et al.* It is clear from the opinions in that case, however, that the legal issues before the Court were different from those here presented, and that the Court was dealing with facts which were different in material respects from the facts in this record. This decision has been made on the basis of the issues and facts presented in this record, without extending it by a detailed discussion to distinguish them from those which were before the Court.)

Scope of the Order

107. Insofar as it relates to the exclusive tying conditions of Carvel's franchising system, the form of order incorporated in the complaint and proposed by counsel supporting the complaint constitutes an appropriate remedy and will be adopted. In other respects, however, the charges of the complaint were not sustained, and the proposed order will be modified.

108. The charge that Carvel precludes dealers from purchasing and selling products not authorized by it (Comp. Par. 7(b)) is factually supported by the evidence (Fi. 26, 39-40, 54). The record also discloses that the dealers sometimes desire to add food products, such as hamburgers and hot coffee, to their lines, and are precluded from doing so by Carvel (CB 32-35, 44-45, 75-76; RB 74-75; RRB 52-53).

109. The Carvel franchise provisions which prevent its dealers from selling unauthorized products, do not require that those products, or the ingredients for them, be purchased only from Carvel. On the contrary, products in the forbidden categories may not be associated with the trade name in the licensed operation, regardless of where obtained. Carvel is not preventing competition with it by others in the sale of such products, or their ingredients, to the dealers, but is protecting what it considers to be the proper use of its name.

110. The Carvel trade name, as used by the dealers, constitutes considerably more than the business name of the store. (See CRB 45.) It identifies a type and quality of products and a method of doing business. In granting to its dealers the right to the use of its trade name, Carvel defined the nature and scope of the business activities which may properly be associated with that name. It licensed the use of the name in an operation specializing in the sale of high grade ice cream products, and there is persuasive evidence that the sale of miscellaneous food products in conjunction with such an operation may seriously impair the good will and value of the name (RRB 52-53).

111. The record does not disclose that the restriction against the sale of unauthorized products is unreasonable or unfair. It obviously prevents the dealers from exercising their independent judgment as to what items they will handle in their stores, but beyond that there is no indication that it substantially lessens competition. On the contrary, it appears to be one of the many requirements through which a considerable degree of uniformity in appearance and operation is achieved as a part of the identifi-

cation of the Carvel trade name and system. The order, accordingly, will not include any prohibitions with respect to it.

112. The charge that Carvel forces its dealers to purchase unnecessary or undesired equipment (Comp. Par. 7(c)) has not been sustained by the evidence, and the order will not include any prohibitions with respect to it. Carvel erects a building, equips it to its specifications with signs, freezers, cabinets, lighting, sterilizing equipment, and other items, and sells the completed establishment ready for operation to a dealer under a franchise agreement (Fi. 22). The record does not disclose, however, that the equipment included in this initial transaction is "unnecessary" or "undesired," and there is no evidence that equipment subsequently sold by Carvel to the dealers is unnecessary to the proper operation of the dealer's store. The requirement that dealers purchase equipment from Carvel, rather than from other sources of their choice, which is not involved in this charge, will, of course, be covered by appropriate provisions of the order.

113. The proposed form of order would include a provision enjoining the receipt of payments by Carvel from suppliers for inducing its dealers to make purchases from such suppliers. Carvel buys equipment, mix and other items, and resells them to the dealers at a margin of gross profit (Fi. 46-53). The evidence does not disclose that Carvel receives a commission or other payments from vendors who sell directly to the dealers, for inducing the dealers to purchase from them, and the order will not include any prohibitions with respect thereto.

114. The proposed form of order would prohibit the use of restrictions which would prevent franchised dealers who have dealt in respondents' products from dealing in similar products after the franchise agreements have terminated. These restrictions of the Carvel franchise agreements are not unreasonable, either in the period of time or area covered, and the order will not include any prohibitions with respect to them. They have been used as ancillary to the enforcement of unlawful restrictions, and those restrictions will, of course, be prohibited.

115. The proposed form of order would prohibit any understanding with Carvel suppliers limiting their right to sell directly to Carvel dealers. The record discloses that companies which manufacture and sell commissary and other items under contract with Carvel, refrain from selling such items directly to the Carvel dealers, and from competing with Carvel and its other suppliers in attempting to sell other items which they produce to dealers (Fi.

41). Although it is reasonable to presume that this results from express or tacit understandings between Carvel and its suppliers, there is no direct evidence to that effect. In any event, Carvel buys from its suppliers, and resells to its dealers, and it is not unreasonable for Carvel to deal only with suppliers who refrain from competing with it in selling to its dealers. This is a fact of business life which may readily be accomplished without any express understanding. The order, accordingly, will not include any provision with respect to such a course of dealing.

116. The proposed form of order also contains provisions which are, in effect, repetitious and confusing by covering in somewhat different language practices which are adequately covered by other provisions. It also contains provisions which, by their breadth of language, would seriously limit the right of Carvel to undertake legitimate sales efforts with its dealers which fall far short of coercion. The proposed form of order will be modified in these respects.

CONCLUSIONS

1. By its franchise agreements, and acts and practices in furtherance thereof, Carvel requires its dealers to purchase ice cream mix, commissary goods and other products only from Carvel. Even though the dealers are granted some latitude with respect to the purchase of equipment from other sources, Carvel has employed threats and coercion to prevent such purchases.

2. Carvel's policing activities have been vigorous and effective, and threats and coercion have been freely employed when needed. Active solicitation of its dealers by Carvel's competitors has been almost wholly eliminated, and substantially the only purchases by Carvel's dealers from such competitors are made under clandestine circumstances, or to meet emergency requirements. Others are effectively foreclosed from competing with Carvel in selling to its dealers, and the dealers, as independent business men, are denied the advantages historically attributed to such competition.

3. The Carvel franchises are "tying agreements" which tie the purchase of equipment, ice cream mix and commissary items to leases and licenses to use the Carvel name, copyright, patents, products and techniques. Carvel has the economic power with respect to the "tying product," the Carvel franchise, to require, and it does require, approximately 340 choice retail outlets to purchase the "tied products," particularly freezers, mix, cones and commissary items, only from it.

4. Carvel's total annual sales amount to approximately \$5,000,000. The manufacturing facilities and warehouse of Carvel are located in New York State, where it receives from sources in various States much of its equipment, commissary items, and other supplies, and from which it makes sales and deliveries to its dealers. More than 25% of its dealers are located in States other than New York. Carvel engages in advertising by radio, television, newspapers and circulars, much of which crosses State lines, and its business is in a condition of growth and development.

5. The record discloses that Carvel has sufficient economic power with respect to the tying product appreciably to restrain free competition in the market for the tied product, and that a "not insubstantial" amount of interstate commerce is affected. Carvel's restrictive agreements and practices have the capacity and tendency substantially to restrain competition in interstate commerce, and the protection of the good will and public acceptance of Carvel products does not necessitate their use. Such agreements and practices, accordingly, constitute unfair methods of competition and unfair acts and practices in violation of Section 5 of the Federal Trade Commission Act.

ORDER

It is ordered, That respondents Carvel Corporation, Dari-Freeze Stores, Inc., Franchised Stores of New York, Inc., Stores of Pennsylvania, Inc., Dari-Freeze Stores of New Jersey, Inc., all corporations, and their officers, and Thomas Carvel and Agnes Carvel, individually and as officers of said corporations, and Chain Locations of America, Inc., a corporation, and its officers, and Carvehicle Corp., a corporation, and its officers, and respondents' agents, representatives and employees, successors or assigns, directly or through any corporate or other device, in connection with the establishment of Carvel or any other ice cream franchised dealers, and in connection with the promotion, contracting, arranging, or offering for sale, sale or distribution of ice cream mix, commissary goods, equipment and other products to said dealers, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from, directly or indirectly:

1. Putting into effect, maintaining or enforcing any franchising, merchandising or distribution plan or policy under which contracts, agreements or understandings are entered into with dealers or distributors which have the purpose or effect of:

(a) Requiring any franchised dealer to purchase all of said products from respondents or sources designated by respondents.

(b) Requiring that any franchised dealer shall not use or deal in products sold by persons other than respondents or sources designated by respondents.

2. Inducing, or attempting to induce, the purchase of said products from respondents or sources designated by respondents by threatening to cancel or not to renew the franchise of a dealer or to take other retaliatory action if said products are not so purchased.

3. Performing any acts of harassment, intimidation or coercion, either through acts or statements, oral or written, made directly to dealers by respondents, or by representatives of respondents, which are designed to have, or which have, the purpose or effect of harassing, intimidating or coercing respondents' dealers to purchase products or equipment sold or leased by respondents or by any supplier designated by respondents.

4. Using or attempting to use any contractual or other device, such as, but not limited to, franchise agreements, leases, options, or conditional sales contracts, for the purpose or with the effect referred to in the foregoing paragraph.

5. Preventing or attempting to prevent, by any means whatsoever, non-designated suppliers from selling or attempting to sell products, goods and merchandise to Carvel dealers.

6. Adopting and placing in effect any plan, scheme, or undertaking which provides that the amount of surcharge, royalty, override, commission or any other payment due Carvel from a Carvel dealer will be raised or affected in any manner by reason of the fact that such dealer has failed to purchase products from Carvel or sources designated by Carvel.

7. Employing any method of inspection, reporting or surveillance in furtherance of any of the acts or practices hereinabove prohibited.

OPINION OF THE COMMISSION

JULY 19, 1965

BY JONES, *Commissioner*:

This matter is before the Commission on cross-appeals of counsel from the initial decision of the hearing examiner which sustained in part and rejected in part the allegations of the complaint. On June 5, 1963, the Commission filed its complaint in this matter against the Carvel Corporation, certain of its wholly-owned subsidiaries, and Agnes and Thomas Carvel in their capacity as owners and major stockholders of these corporations, charging them with violating Section 5 of the Federal Trade Commission Act by reason of the terms and provisions of their franchise agreements with their franchisees.

The complaint alleged that Carvel was engaged in the business of licensing franchise distributors to sell at retail soft ice cream and other associated products under the Carvel trademark. The complaint charged that Carvel's franchise agreements were illegal insofar as they required each franchise licensee-dealer:

- (1) To purchase its entire supply of ice cream mix and associated products from Carvel or from persons designated by Carvel;
- (2) To refrain from selling any products not authorized by Carvel;
- (3) To purchase various items of equipment from Carvel;
- (4) To adhere to those contract provisions through a rigorous policing system involving threats and coercion directed to dealers and to nonapproved suppliers;
- (5) To refrain from entering into a similar business within three years after termination of the franchise.

After extensive hearings, the examiner concluded that the Carvel franchise agreements are illegal "tying agreements" which tie the purchase of equipment, ice cream mix and commissary items to licenses "to use the Carvel name, copyright, patents, products and techniques" and consequently violative of Section 5 of the Federal Trade Commission Act. He found that Carvel's policing activities have been vigorous and effective, and threats and coercion have been freely employed to enforce the restrictive provisions of the agreement. Respondents' argument that the restrictive provisions were required as a business and economic necessity in order to protect the Carvel trademark, the dealers and the consuming public was rejected by the examiner. He did, however, conclude that the negative covenant and the requirement that dealers sell only prod-

ucts authorized by Carvel were reasonable and did not constitute violations of law.

We are of the view that the hearing examiner is in error in his ruling that Carvel's franchise agreements were illegal tying arrangements and in his conclusion that the restrictions imposed on the Carvel dealers' purchases of their mix, commissary items and equipment, or the steps taken to enforce these provisions are otherwise violative of Section 5 of the Federal Trade Commission Act. We agree with the examiner's conclusions as to the reasonableness of the covenants not to compete and the prohibition against the sale of unauthorized products.

We will consider each of these rulings seriatim in the discussion below.

I

The Evidence Developed at the Hearings

A. The Carvel Operation

Thomas Carvel, having developed his own freezer and soft ice cream mix, was, prior to 1949, primarily engaged in the business of manufacturing and selling freezers for the production of soft ice cream. Because of the unsuccessful operations of many of the purchasers of his freezers, Carvel decided in 1949 not to install equipment unless it controlled the operation of the store, and to this end began the development of a system of franchising retail dealers.

Under its franchise agreements, Carvel licensed dealers to use the applicable Carvel patents, copyrights and procedures, and to operate roadside stands to sell Carvel trademarked ice cream and related products.¹

B. The Carvel Product

The primary product sold by the roadstand retail dealers, and the one around which the Carvel operation is built and with which this case is concerned, is ice cream dispensed, usually in a twist pattern, directly from the freezer into an edible cone or a paper cup, and served immediately to the consumer. It is served to consumers as it comes from the freezer, with the addition of a variety of sundae toppings, such as syrup or fudge of various flavors, nuts and fruits. It is also used as it comes from the freezer in the prepa-

¹ Carvel also franchised "in-town stores" for the sale of a wider variety of ice creams, and "H-burger" dealers for the sale of non-ice cream products, including hamburgers, chicken, milk shakes, coffee and carbonated drinks. While H-burger dealers could also be Carvel roadstand dealers, they were required to keep the premises separate and distinct.

ration of individual orders of thick milk shakes. The dealers' premises, the paper cones and all the various associated items used in the sale of Carvel's soft ice cream all bear the Carvel trade name or trademark and are all of identical design in accordance with Carvel's design patents.

Carvel dealers use the same ice cream mix in the manufacture of a variety of specialty items which are made up in advance and hardened at very low temperatures for future sale (generally as "take home" items), to consumers.

Carvel has developed a formula for a combination emulsifier-stabilizer which is used for the purpose of making homogeneous the combination of solids and liquids from which its soft ice cream mix is made. This emulsifier-stabilizer is made for Carvel by a single manufacturer in accordance with what the examiner found to be Carvel's secret formula, and is furnished by Carvel to certain authorized dairies which produce the Carvel mix under contract with Carvel in accordance with specifications also furnished them by Carvel and at prices designated by Carvel. Carvel dealers must purchase their Carvel ice cream mix from these authorized dairies.

The toppings, flavors and other ingredients incorporated in the soft ice cream manufactured by the dealers are referred to generally as commissary items. Many of these items are produced under formulas developed by Carvel, and are manufactured by various companies for Carvel according to its specifications. Other commissary items regularly produced by manufacturers (not under Carvel specifications) are modified or adapted in certain respects to meet the Carvel requirements and specifications. All of these items are packaged for Carvel under its trade name, are purchased and warehoused by Carvel, and sold and delivered by it to the dealers.

Ice cream cones are also purchased by Carvel from two manufacturers and are resold by Carvel to the dealers. These cones involve certain distinctive features and are identified with the Carvel name on the cartons in which they are delivered to the dealers. Certain types of the cones are also identified with a private brand, "Major," and others are in individual paper wrappers marked with the Carvel name.

The freezer equipment is available from Carvel and portions of it are patented. Parts of the equipment not essential to the production of the soft ice cream may be purchased from non-Carvel sources.

C. The Carvel Franchise Agreements

Under the franchise agreement, the dealer is required to purchase from Carvel, or from sources designated by Carvel, his entire requirements of mix, toppings, flavors and other ingredients, cones and any other items which constitute a part of the end product sold at retail to the consuming public.

The dealer is also required to purchase and use only the manufacturing and dispensing freezer manufactured by Carvel and is encouraged to purchase his other associated equipment from Carvel. The dealer is given some latitude in purchasing such other equipment from other sources with the approval of Carvel, but is closely supervised in the purchase and use of such equipment. The examiner found that Carvel discourages this practice and that relatively little equipment is purchased by dealers from other sources.

The dealers are also required, by the terms of the franchise agreements, to operate in strict accord with standard operating procedures prescribed by Carvel which regulate the operation of the store and equipment, the sanitation procedures which must be followed, the methods to be used as respects flavoring, freezing and dispensing the ice cream mix, the varieties of ice cream and other products which may be manufactured from the basic mix. Dealers are not permitted to manufacture or handle any products not specifically prescribed.

The franchise agreement authorizes Carvel to inspect the store records and operations of the dealer at such time as it desires.

Franchise agreements, originally effective for 10 years with a renewal provision for another 10 years, were at the time of suit reduced to a 5-year period with a 5-year renewal provision. Breach by the dealer of any of the terms of these franchise agreements entitled Carvel to terminate the franchise, with liquidated damages against the dealer. In the event of the termination of a franchise, irrespective of the cause, Carvel has the right to purchase all of the dealer's machinery and equipment in the store at a depreciation of its original cost of 50% during the first year, with further depreciation in later years.

Upon termination, the dealer is presently prohibited by the agreement from engaging in the sale of frozen dairy products for a period of three years within three miles of the store he operated. (Prior to the suit, the period had been five years and 25 miles.)

D. Carvel's Market

Carvel has manufacturing facilities located in Yonkers where it produces, and from which it delivers, much of the equipment sold

to its dealers. Commissary items and other supplies purchased by Carvel from sources in various States come into its warehouse in New York, from which they are delivered to its dealers. Dealers to which Carvel makes sales and deliveries from its New York facilities are located in New York, New Jersey, Connecticut, Pennsylvania, Florida, Massachusetts, Maryland, and Wisconsin, and it engages in advertising by radio, television, newspapers and circulars, much of which crosses State lines.

In 1959, Carvel's total sales took place principally in a 5-State area consisting of Connecticut, New York, New Jersey, Massachusetts, and Pennsylvania, and totaled approximately \$5 million, of which 70% is accounted for by Carvel sales in New York State. Sales of soft ice cream mix by Carvel to its dealers increased from 856,660 gallons in 1960 to 1,047,440 gallons in 1962.

There are approximately 340 franchised Carvel dealers, including roadside stores, in-town stores and H-burger dealers. The vast majority of these stores are located within a 100-mile radius of New York City with the highest concentration of these retail outlets in the New York City-Nassau-Suffolk area. The concentration of Carvel outlets in other areas and in other States is at this time very limited.

Ice cream mix supplied to Carvel dealers is delivered to them by dairies located in the several local areas near the dealers, and these deliveries cross State lines only to a very limited extent. All of the ice cream mix supplied to the Carvel dealers in the New York City-Nassau-Suffolk area was delivered by two dairies located in New York, and the evidence with respect to Carvel's share of the mix market in that area is based upon intrastate deliveries of mix. The same restrictive conditions, however, apply to all Carvel dealers, including some who receive interstate deliveries of mix, and many who receive interstate deliveries of commissary and other items from Carvel.

Complaint counsel maintained that the proper market for the purposes of this case was the soft ice cream mix market in the area bounded by New York City and Nassau and Suffolk counties, of which Carvel had 37.7%. Respondents contended that the appropriate product line should be ice cream mix for soft and hard ice cream in which Carvel's share in this geographical area was approximately 4.5%.

The record contains little precise data on the number and size of other producers and retailers of soft ice cream mix or of the commissary items and equipment used in their production.

II

*Discussion of the Issues Presented on the
Cross-Appeals of the Parties**A. The Carvel Franchise Agreements as Tying Arrangements*

Carvel's franchise agreements cannot be regarded as tie-in arrangements because the trademark license conceptually cannot constitute a "tying" product and, even if it could, it could never be regarded as a separable "product" apart from the mix and commissary items to which it is attached within the meaning of the typical tie-in arrangement. In reaching this conclusion, we are not viewing the Carvel franchise agreement in a rigid or doctrinaire manner. In our view, it is neither a typical tie-in arrangement such as would render it vulnerable under the Sherman Act, nor does it have any of the characteristics of such an arrangement nor any other elements of unfairness such as would subject it to Section 5 of the Federal Trade Commission Act. *Cf. The Atlantic Refining Company v. F.T.C.*, 381 U.S. 357, 369 (1965).

(1) Nature and Extent of Trademark Owner's Interest in Maintaining His Mark

A trademark has been generally defined as "a distinctive mark of authenticity, through which the products of particular manufacturers of the vendible commodities of particular merchants may be distinguished from those of others." *Black's Law Dictionary*, p. 1665; *Application of McIlhenny Co.*, 278 F. 2d 953 (C.C.P.A. 1960). The Lanham Act,² the major piece of federal legislation governing trademark usage, defines a trademark as follows:

The term "trade-mark" includes any word, name, symbol or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others 15 U.S.C.A. 1127.

The courts have traditionally held that the property right in a trademark exists only as an adjunct to the product which it identifies. *Trademark Cases*, 100 U.S. 82 (1879); *Trade-Marks and Unfair Competition*, 68 Har. L. R. 816 (1955). A trademark right is not a right in gross or at large. "There is no such thing as property in a trademark except as a right appurtenant to an established business or trade in connection with which the mark is employed." *United Drug Co. v. Rectanus Co.*, 248 U.S. 90, 97 (1918). "A trademark cannot travel to places where there is no article to bear

² 60 Stat. 424 (1946); 15 U.S.C. 1051-1127 (1958).

it and no trader to supply the article." *Denison Mattress Factory v. Spring-Air Company*, 308 F. 2d 403 (5th Cir. 1962).

Originally, the purpose of trademarks was to represent to the consumer the source or origin of the product to which they were affixed. Under more recent theories, trademark licensing has been permitted where goods do not emanate from a common source.³ However, under present trademark law, a trademark owner, in order to retain his right to his mark, must, when he elects to license others to use his mark, retain sufficient control over his licensees' dealings in the end product to insure that they will apply the mark to either the same product or to one of substantially the same quality with which the public in the past has associated the product. *Smith v. Dental Products Co.*, 140 F. 2d 140 (7th Cir. 1944), *cert. denied*, 322 U.S. 743 (1944); *Purity Cheese Co. v. Ryser Co.*, 153 F. 2d 88 (7th Cir. 1946); Sec. 45, 1946 Lanham Act, as amended, 15 U.S.C. 1127 (1958).

In general, the most usual means employed by trademark owners to maintain the necessary quality control over their licensee manufacturers or sellers embraced requirements that the licensees manufacture in accordance with actual samples submitted, *Alligator Co. v. Robert Bruce, Inc.*, 176 F. Supp. 377 (E.D. Pa. 1959), and *Manishevitz Food Products, Inc. v. Rosenberg*, 39 TMR 231 (E.D. Pa. 1949); that licensee dance studios, for example, employ only instructors trained by the licensor and follow only dance procedures laid down by the licensor, *Arthur Murray, Inc. v. Horst*, 110 F. Supp. 678 (D. Mass. 1953); or that licensee bakeries be required to purchase the batter mix exclusively from the licensor, *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F. 2d 358 (2d Cir. 1959). These cases also make it clear that a licensor must inspect its licensee's operation in order to maintain the control required by the trademark law if the mark is not to be treated as abandoned.

It seems clear that since no property right inheres in a trademark apart from the product or service to which it relates, and since trademarks may be licensed but only on condition that the trademark owner retains control over the licensee's use of the trademark, it is conceptually impossible, in our opinion, to view a license to use a trademark as separate and distinct from the sale of the trademarked product or its ingredient. The Carvel franchise served the single purpose of permitting the dealer to sell the trademarked products as trademarked, and the sale to the licensee of the mix and other products cannot really be separated from the

³ *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 Yale L. J. 1171 (1963).

license. Both were necessary in combination to permit the dealer to exercise fully the license.

Moreover, tie-in arrangements must involve two separable and distinct products and have been held not to exist where the courts concluded that the two products could not be disassociated from each other. *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953) (advertising space in morning and evening papers same product to advertisers); *International Mfg. Co. v. Landon, Inc.*, 1964 Trade Cases, Par. 71,229 (9th Cir. 1964) (package patents related to same device held one product); *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960) (sale and service of complex equipment held not involving separable products). Since Carvel's franchise for the sale of Carvel products and its license to use are part of a single package, we conclude that the examiner erred in holding that the Carvel franchise agreements were illegal tie-in arrangements.

(2) *Validity of Carvel's Trademark Licensing Agreements Under the Antitrust Laws*

The hearing examiner was correct in his premise that the mere fact that restrictive provisions are part of a trademark licensing arrangement is not sufficient to immunize these provisions from the antitrust laws. The Supreme Court in *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), made it quite clear that trademark agreements are subject to the antitrust laws. The Court stated that the test of their validity turns on whether their primary purpose was to protect the licensor's trademarks or to restrain trade. As the Supreme Court put it:

Nor can the restraints of trade be justified as reasonable steps taken to implement a valid trademark licensing system, Appellant's premise that the trade restraints are only incidental to the trademark contracts is refuted by the District Court's finding that the "trademark provisions [in the agreements] were subsidiary and secondary to the central purpose of allocating trade territories." Furthermore, while a trademark merely affords protection to a name, the agreements in the present case went far beyond protection of the name "Timken" and provided for control of the manufacture and sale of antifriction bearings whether carrying the mark or not. A trademark cannot be legally used as a device for Sherman Act violation. Indeed, the Trade Mark Act of 1946 itself penalizes use of a mark "to violate the antitrust laws of the United States" (at 598-599).

However, not all covenants in restraint of trade are void. It is clear from *Timken* that a conventional restraint of trade may be permitted where the covenant embodying it is merely "ancillary"

to the principal purpose of a lawful contract. See also *U. S. v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898).

Subsequent cases involving this question of the validity under the antitrust laws of restrictions imposed on trademark licensees have applied this same "ancillary-primary" test and have sustained the validity of restrictions very similar to those involved in the Carvel agreement. For example, in *Denison Mattress Factory v. Spring-Air Company*, 308 F. 2d 403 (5th Cir. 1962), the Fifth Circuit upheld a licensor's requirement in its trademark licensee agreements that its bedding manufacturer-licensees purchase all their ticking, innerspring units and labels from the licensor as a reasonable means on the part of the licensor to control the nature and quality of its own trademarked bedding. The court specifically rejected plaintiff's argument that the license agreements were illegal tie-in arrangements and pointed out that:

The trademark would be of no worth unless the public could be sure that every mattress which bore that mark was uniform both in exterior design and interior quality. Denison [one of the licensees] must accept the judgment of Spring-Air on this requirement (p. 410).

Several other cases, involving substantially similar restrictions imposed on licensees, have all uniformly upheld these restrictions both under the Sherman Act and under the Federal Trade Commission Act as a valid and reasonable exercise of the legitimate business interests of the trademark owner in protecting his mark and insuring the quality and uniformity of his product. *Engbrecht, et al., v. Dairy Queen Company, et al.*, 203 F. Supp. 714 (D.C. Kans. 1962); *Baker v. Simmons Company*, 307 F. 2d 458 (1st Cir. 1962); *Brosious v. Pepsi-Cola Co.*, 155 F. 2d 99 (3rd Cir. 1946); *United States v. Sealy, Inc.* (N.D. Ill. October 1964), 1964 Trade Cases, Par. 71,258; *Coca-Cola v. Butler*, 229 Fed. 224 (D. Ark. 1916); *The Coca-Cola Bottling Co. v. The Coca-Cola Company*, 269 Fed. 796 (D. Del. 1920).

Applying the principles of these cases to the Carvel agreements, we conclude that the hearing examiner was wrong in his conclusion (1) that the Carvel agreements were part of a general plan and purpose to restrain interstate commerce, and (2) that the restrictions imposed on Carvel's licensees were not reasonably related to Carvel's right—and obligation—to control the quality of its trademark product and the identity and image of its trade name.

(a) *Carvel's Over-all Plan to Restrain Trade*

The hearing examiner's finding on this point is undocumented. We find nothing in the record which would in any way suggest that

Carvel's franchise agreements were entered into as part of any over-all plan to restrain trade.

The examiner apparently reached his conclusion that Carvel was engaged in an over-all plan to restrain trade because of his belief that the Carvel franchise program was developed and carried out, not as a means of protecting Carvel's trademarks but to enable Carvel to make inordinate profits on its Carvel products by establishing a captive market (its licensees) to which Carvel's mix and commissary items could be sold. There is nothing in the case law or in logic to use such a theory in support of an inference of an illegal plan to restrain trade. Nor, as a matter of fact, does the evidence of record provide any factual support for such a theory. The record establishes that as to some products, notably mix, the dealers pay no more to Carvel than they would to others. There is evidence of significant mark-ups by Carvel on certain products, but no evidence as to Carvel's expenses of storage, delivery and spoilage, or as to prices charged by others for comparable products, and therefore no basis on which to evaluate whether Carvel was making inordinate profits out of its captive market. We hold that the examiner was in error in reaching this conclusion as to Carvel's over-all illegal plan.

(b) *Reasonableness of Restrictions Imposed on Carvel's Dealers*

Complaint counsel's argument, accepted by the hearing examiner, was that Carvel's restrictions on the dealer's sources for mix and other items were unreasonable because Carvel could have achieved the same objective of quality control by prescribing specifications for the production of its mix rather than requiring that the mix be purchased from specified approved sources. Presumably under this argument, if the alternative of prescribing specifications had been adopted, any dairy or other supplier able to meet these specifications for mix and other commissary items could be eligible to compete in the sale of these items to the Carvel outlets, and hence the agreements would not have foreclosed any market outlets to anyone.⁴

Respondent, on the other hand, argued that the challenged restrictions were essential for it to protect the secrecy of its mix formula and second, to enable it to insure the uniformity and quality of its end product sold to the consumer. Respondent also argued that wide dissemination of their specifications would involve an inordinate inspection and policing job and leave them

⁴ The question of whether any substantial foreclosure from the market resulted from the agreements as executed is dealt with separately.

vulnerable to the use by their dealers of inferior products which could damage the Carvel name.

There is no case which has held that a trademark licensor must itself manufacture the trademarked products or their ingredients in order to retain control over the quality and uniformity of such products. Nor has any case held that such a licensor must give unrestricted approval to any person desiring to supply these products to its trademark licensees.

The hearing examiner nevertheless held that Carvel's restrictions on its dealers' sources of supply of the mix and commissary items were illegal because respondents, rather than limiting the sources of such products, could have prescribed specifications for their manufacture. In so doing, the hearing examiner relied on the Supreme Court's statement in *Standard Oil v. United States*, 337 U.S. 293, 306 (1949), to the effect that:

Tying agreements serve hardly any purpose beyond the suppression of competition. The justification most often advanced in their defense—the protection of the good will of the manufacture of the tying device—fails in the usual situation because specifications of the type and quality of the product to be used in connection with the tying device is protection enough. * * * The only situation, indeed, in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied.

However, clearly the Court in this statement was not attempting to lay down any broad rule affecting license arrangements entered into by trademark licensors. On the contrary, the Court was dealing there with the legality of requirement contracts, and its statement was made in the course of a review of Supreme Court decisions involving Section 3 of the Clayton Act, in which the Court was differentiating between tying arrangements and exclusive dealing contracts. No issue with respect to specifications was involved in that case. In a trademark situation, such as we are faced with here, the asserted justification for the challenged restrictions is primarily the need to achieve a specified quality of product and the avoidance of consumer deception by supplying a uniform product at each Carvel store. Quality might be achievable by specifications whereas uniformity in all probability could not be. Consequently, the Supreme Court's language in the *Standard Stations* case, relied on by the examiner, would not necessarily be applicable to the present case where a trademarked product as distinctive as a food is involved.

Even assuming that some rule of practicable alternatives should in an ordinary case be invoked to determine the legality of this

type of restrictive provision in a trademark license agreement, the record is insufficient in this case to support the examiner's conclusion that prescribing specifications would have produced the requisite quality control and uniformity in the Carvel products.

The evidence of record indicates that Carvel did in fact furnish both its secret formula and specifications to the approved suppliers. Respondents, however, introduced testimony that the mix could not have been adequately controlled unless Carvel restricted the sources from which it could be purchased. No counter evidence was offered by complaint counsel. While ease of administration should not be a controlling factor where trade restraints are involved, nevertheless, the inspection burdens on Carvel as respects both dairies and dealers in order to insure the quality and uniformity of the mix used by its 340 dealers, if they were free to purchase it from any source provided it was made according to Carvel's specifications, would appear to be untoward in the light of the potential restraint involved here. Moreover, there is nothing in this record which establishes even a likelihood or possibility that Carvel could have achieved the same uniformity of quality if it had broadened its list of approved suppliers of its mix.

In this connection it is interesting to note that in *Susser v. Carvel*, 332 F. 2d 505 (2d Cir. 1964), *cert. dismissed*, 1965 Trade Cases, Par. 71,435, a private action considering these same franchise provisions, the majority concluded on the merits that adequate control over the Carvel product could not be achieved through specifications. The majority noted that designating specifications might be possible for the manufacture of mechanical products, but then observed that:

Such cases are scarcely relevant to the problem of controlling something so insusceptible of precise verbalization as the desired texture and taste of an ice cream cone or sundae; that Carvel was able to specify this to its source of supply, whose product is regularly checked, does not show that administration could be confided to 400 dealers (at p. 520).

This same factual conclusion was also reached by the District Court in the *Dairy Queen* case, *supra*, where the court specifically recognized that the Dairy Queen's soft ice cream mix had an important bearing on the taste, texture and quality of the end product sold, and that uniformity could not be achieved by allowing dealers to purchase the mix from whomever they chose.

We do not believe that these same problems of uniformity of quality and ease of administration are present with respect to Carvel's requirement that commissary items such as toppings,

nuts, cones, and the like, must be purchased from Carvel. It does not strain credulity for us to conceive that Carvel could have designated approved suppliers for such items. The factors which necessitate that Carvel designate the supplier of the basic ingredient, the soft ice cream mix, are not as demanding with respect to these other items which can be more easily specified and which do not constitute such an integral part of the final product. Nevertheless, the record is almost completely silent on the amount of commerce involved in these items or on any other factors respecting Carvel's practices in this regard. We conclude, therefore, that on this record, the nature of any possible restraint flowing from this restriction is in all likelihood so *de minimis* in view of Carvel's share of the purchasing market for these items, which is probably less than one-tenth of one percent, that an order prohibiting such a restriction is unwarranted.

(4) *The Substantiality of Commerce Affected by the Carvel Franchise Agreements*

There is no dispute that respondents are engaged in interstate commerce and that the agreements which are the subject of this proceeding operate and are effective on a broad interstate area. The hearing examiner found that the proper product line and geographic area for evaluating the competitive effects of respondents' franchise agreements was soft ice cream sold in the New York City-Long Island market area. So viewing the market, the examiner found that respondents had the capacity substantially to lessen competition in the intrastate area and then inferred that such capacity existed in the broader interstate area where Carvel operated. Respondents have argued, however, that by the selection of such a geographic area, which is solely intrastate, complaint counsel has failed to show that the complained of practices have affected interstate commerce.

Respondents' franchise operations are carried out in a 5-State area, and the challenged franchise agreements and practices relating thereto are entered into and effective not only in the New York City area selected by complaint counsel to illustrate the effects of respondents' agreements but throughout the various States where Carvel dealers are located. Consequently, practices which are carried on *in commerce* and which may be violative of Section 5 should not escape Commission action merely because the proof of the precise effects is in a market area encompassing only one State. *F.T.C. v. Bunte Bros.*, 312 U.S. 349 (1940).

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The hearing examiner also found that Carvel had sufficient economic power in the tying product (the franchise) appreciably to restrain trade in the "tied" product (the mix and commissary items), and that a "not insubstantial amount" of commerce was involved. While we do not agree that Carvel's franchise agreement constitutes a tying arrangement, even if we were to view this arrangement as in the nature of such a tie, neither the law nor the record evidence is sufficient to support a finding of illegality.

A trademark, by itself, is not regarded as conferring monopoly power on its owner, as is the case with a patent. *United Drug Co. v. Rectanus Co.*, *supra*. The majority of the Second Circuit in the *Susser* case, *supra*, when viewing the Carvel trademark as the allegedly tying product, distinguished between a patent and a trademark, and concluded that the Carvel mark had not acquired such pre-eminence so that the coupling with it of the requirement to purchase ingredients from designated sources constituted a *per se* violation.

Absent monopoly power, the test of the illegality of a tying arrangement turns on whether:

a [tying] party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a not "insubstantial amount" of interstate commerce is affected. *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 6 (1958).

Viewed in this context, the evidence will not support the examiner's conclusion that Carvel possessed "sufficient economic power with respect to the tying product."

While the Carvel trademark undoubtedly enables its licensees to compete more effectively because of the goodwill attaching thereto, it is impossible to conclude from the evidence of record that respondents have sufficient dominance in the soft ice cream business to use their trademark as an effective weapon to pressure prospective dealers into taking the so-called "tied" items. The vice of tying arrangements lies in the ability of a producer who possesses market dominance in one particular product to impose upon his vendee the obligation to purchase other products as to which the producer possesses no market dominance, with the consequent foreclosure of other producers or, as the Supreme Court put it in the *Atlantic Refining* case, *supra*, "the utilization of economic power in one market to curtail competition in another."

From this record, it is impossible to conclude that Carvel possesses the requisite dominance or economic power in the soft ice cream business. It is apparent that there are numerous other fran-

chise chains and independent operators engaged in the sale of soft ice cream, although no evidence as to their relative size or precise number is of record. However, there is nothing in the record to indicate that their trademark goodwill is any weaker, or enjoys less acceptance by, or is less familiar to the public than Carvel's.

There is nothing in the record which indicates that the soft ice cream market is difficult to enter. Nothing suggests that there is any difficulty in purchasing on the open market the requisite freezers, equipment and supplies. In fact, complaint counsel relies on the existence of such other suppliers in arguing the foreclosure of Carvel dealers as an outlet for their wares. The capital requirements for entry into the soft ice cream business are not extensive, and the record indicates that adequate financing is readily available. With the virtual absence of barriers to entry into this business, it is virtually impossible to conclude that respondents have the requisite economic power in their trademark to force potential entrants into the soft ice cream business to enter into an agreement requiring them to purchase undesired and inferior products from Carvel.

The only evidence offered by complaint counsel, and relied upon by the examiner, in support of the contention of sufficient economic power in the so-called tying product is the fact that the sales of the Carvel dealers in the relevant market area accounted for 37% of the total soft ice cream sales in that market.⁵ In view of the obvious ease of entry into this market, as set out above, and the fact that there are at least eight other soft ice cream producers who are, so far as we know at least, potential competitors of Carvel in this market, this 37% figure alone is not conclusive of dominance or of substantiality.

Even if it be determined that Carvel's 37% share of the market measures the dominance which it enjoys over the Carvel name, the tying product, complaint counsel must also show that a not insubstantial amount of commerce be affected in the tied products, that is, in the mix and other commissary items. Nothing was developed in the record respecting the volume of sales of the commissary items, other than mix, which are also allegedly tied to the franchise agreement. These items include such products as chocolate syrup, nuts, paper cups, cherries, and the like. It is reasonable to assume that Carvel's share of the market in those items in the New York area must be infinitesimal.

⁵ Sales are equated with the purchases of soft ice cream mix.

The question of substantiality, therefore, can only be in issue as respects the mix. Respondents contend that if soft and hard ice cream is the proper market, then Carvel's share of the New York market is only 4% and not 37%. However, it is immaterial which market one chooses for evaluating substantiality, as we do not believe that it has been established in either market.

The theory of injury in complaint counsel's case is principally the foreclosure of Carvel dealers as possible market outlets for other manufacturers of soft ice cream mix. Reliance is placed solely on the percentage share of soft ice cream mix consumed by the Carvel dealers. However, the Carvel franchise agreement, which is in fact an exclusive distributorship agreement, should be evaluated in terms of the criteria set down in *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961), for viewing exclusive dealing arrangements, and that the alleged foreclosure of mix suppliers from the Carvel market should be determined in a broader economic context in an effort to determine "the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein."

However, the record is barren on this point. The record is silent as to the operations of the dairies. It does not tell us whether there is something distinct about soft ice cream mix or whether it can be utilized as hard ice cream mix with the addition or subtraction of an ingredient or the turn of a valve. Furthermore, we have no idea of what percentage of the dairies' sales are accounted for by the sale of soft ice cream mix. If soft ice cream mix accounts for a minimal amount of the dairies' over-all sales, and if they can turn to the production of one or the other, depending on their estimate of the market, or on other factors, then we fail to see how the foreclosure of these dairies from Carvel's share of the market, regardless of how significant in percentages, can substantially lessen competition.

B. Other Issues

(1) *Franchise Provisions Prohibiting Sale of Non-Carvel Products*

The hearing examiner found that Carvel's restrictions on its dealers' purchases of such foods as hamburgers, hot dogs, coffee and the like, were reasonably related to the protection of the Carvel trademark and hence were lawful. Carvel officials testified that the ban on the sale of unauthorized products was necessary to protect the proper use of its name and prevent the dealers from

deceiving the public by "palming off" non-Carvel products as products originating from Carvel when in fact they were in no sense controlled by Carvel. When additional products were added to the Carvel line from time to time, they were always variations of the basic ice cream product. While the examiner recognized that such a restriction prevents the dealers from exercising their independent judgment as to what items they will handle in their stores, he also found that the restrictions helped Carvel to achieve a considerable degree of uniformity in appearance and operation identified with the Carvel trade name and system. Furthermore, he concluded that "there is no indication that [such a provision] substantially lessens competition." We agree with this conclusion. Except in very minor respects,⁷ there is no competition between Carvel and the manufacturers or distributors of the products which the dealers are unable to sell. Consequently, the Clayton Act cases dealing with the prohibition against the sale of competing products have little applicability to this situation.

The Carvel trademark covers not only the Carvel ice cream sold by Carvel dealers but also the type of retail outlet at which Carvel ice cream shall be sold. It seems clear that noncompetitive products sold in a specially designed store displaying the Carvel name would be attributed to that name, and any defects in quality, over which Carvel would have no control, would detract from its name and goodwill. Under these circumstances, such a restriction seems reasonably ancillary to respondents' principal purpose of protecting their goodwill and their trademark image.

(2) *Use of Coercion to Enforce the Franchise Agreements*

The hearing examiner found that respondents had used threats of franchise termination and litigation as well as vigorous policing activities for the purpose of obtaining compliance by the dealers with the restrictive provisions of the franchise agreements. These practices, the examiner concluded, resulted in the cessation of solicitation of the Carvel dealers by unauthorized suppliers and the limitation of purchases from such dealers to "clandestine circumstances, or to meet emergency requirements."

The trademark cases make it clear that the licensor of a mark is required to carry out inspections to see to it that its licensees

⁷ The only way in which this problem remotely approaches effects on commodities of competitors of Carvel is the assertion by complaint counsel that such restrictions coerce dealers into purchasing additional franchises from Carvel, such as the H-burger franchise. The substantiality of such a foreclosure of hamburgers in view of the *Tampa Electric* criteria would appear almost minuscule.

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are not deceiving the public by providing them with something other than that which the trademark embodies. Failure to do so may result in such misuse of the trademark that it could be considered abandoned. It is, therefore, apparent that the threats of cancellation and legal action and the conducting of repeated inspections where violations had been detected were utilized for the purpose of preventing the deterioration of the Carvel trademark. Such actions were not "harassment and intimidation" for some invidious purpose, but rather the legitimate policing of the licensees by a licensor desirous of protecting his trademark.

Since in our view the restrictive provisions of the franchise agreement were reasonable and lawful, we do not believe that their enforcement by Carvel renders them any less lawful. Nor do we find anything in the record tending to show that respondents' enforcement measures constituted by themselves an anticompetitive act. The evidence of enforcement simply reflects that Carvel insisted that the dealers obey the franchise prohibition on purchasing Carvel items from unauthorized sources. We do not believe that these practices by Carvel constituted unfair acts of competition.

(3) *Purchases of Equipment*

As part of the alleged illegal tie-in effect of Carvel's franchise agreements, the complaint charged that Carvel in effect coerced dealers into purchasing all of their freezer and associated equipment from Carvel. There is no requirement in the Carvel franchise agreement that such equipment be purchased from Carvel. However, the examiner concluded that in fact Carvel dealers were coerced into purchasing their equipment from Carvel and that this practice was illegal since it prevented other suppliers from selling to Carvel dealers.

After a review of the record on this point, we do not believe that the evidence will support the examiner's finding. Respondents offer for sale, and sell, freezer and other related types of equipment for use in the operation of a Carvel franchise store. It is not disputed that the dealers are informed of their option to purchase such equipment from respondents or from other suppliers, so long as such equipment meets Carvel's standards and specifications. In support of their contention that dealers buy and use equipment not made or sold by Carvel, respondents offered in evidence certain worksheets which demonstrated that at least 70 Carvel stores purchased outside equipment (RX 147). This equipment consisted of, among other items, milk machines, holding boxes, refrigerated counters, shake machines and upright freezers. Further-

more, numerous dealer witnesses testified that they were aware that they could purchase equipment from outside sources and in many instances they did. They testified that they had little difficulty in having the specifications for such equipment approved, and even in situations where they failed to request such approval, they had no difficulties with respondents when the equipment was noted during the course of routine inspections. The record, moreover, is completely silent on the amount of equipment involved and the extent to which competitive suppliers are in fact foreclosed from the Carvel dealer market. Accordingly, we conclude that complaint counsel failed to carry its burden of establishing either that a tie-in arrangement was involved or the substantiality of the commerce involved.

(4) *The Negative Covenants*

The Carvel franchise agreements prohibit a dealer whose franchise is terminated, either by his own volition or that of Carvel, from operating a soft ice cream store within a 3-mile radius of his former location for a period of three years.⁸ The hearing examiner, while finding that such a provision had been used to assist in enforcing the restrictive provisions of the franchise agreement, concluded that the negative covenant is not unreasonable either as to the period of time or area covered.

Complaint counsel argues that this limitation on a dealer's right to continue in the soft ice cream business after termination coerces dealers to comply with the purchase requirements of the franchise agreement, and therefore is illegal. Respondents point out that the covenant applies only in the limited situation where Carvel elects to continue to operate the vacated dealership on the same premises. Its purpose is solely to protect the new dealer of the Carvel outlet against possible unfair competitive activity in the immediate neighborhood by the previous operator. Respondents also argued that there has been no instance where Carvel attempted to enforce this negative covenant. There is no evidence in the record respecting the origin or operation of these negative covenants.

Restrictive clauses of this type are not illegal *per se*. Their legality turns either on whether they are unreasonable as to time or geographic scope or on whether they have the substantial capacity to enforce or coerce compliance with other illegal contractual provisions or practices. *Rural Gas Service, Inc.*, 59 F.T.C. 912 (1961); *Mytinger & Casselberry, Inc., v. F.T.C.*, 301 F. 2d 534

⁸ Originally the prohibition was for five years in a 25-mile radius of his former location.

Order

68 F.T.C.

(D.C. Cir. 1962); *Snap-On Tools Corp. v. F.T.C.*, 321 F. 2d 825 (7th Cir. 1963).

It seems obvious that a Carvel dealer could have built up a sufficiently great personal following during his tenure as a Carvel dealer so as to constitute a formidable competitor to his successor if he should enter a similar business in the nearby area. This is especially true with the "drive-in" type of store, because once a customer has to drive, he may be willing to go a little further to have his soft ice cream dispensed by the previous dealer. Accordingly, it does not seem unreasonable to us in this situation to impose a 3-mile and 3-year limitation on the right of a terminated dealer to engage in a competitive business after termination.

There is no evidence that this covenant plays any significant role in achieving compliance with the terms of the franchise agreement although it could have such effect. However, on our view of the law and facts in this case, the other provisions of Carvel's franchise agreements have not been shown to be unlawful. The termination clause itself would be sufficient incentive to the dealer to adhere to these provisions, and it is difficult to conclude that, in a business such as this, the dealer's inability to compete *after* termination would constitute any real or further coercion.

The hearing examiner was correct in his conclusion that this covenant was not illegal.

CONCLUSION

For the reasons discussed above, we believe that the hearing examiner was wrong in holding that Carvel's franchise agreements violated Section 5 of the Federal Trade Commission Act.

Accordingly, the complaint against respondents is dismissed.

Commissioner Dixon did not participate.

Commissioner Reilly concurred in the result.

ORDER DISMISSING COMPLAINT

This matter having been heard by the Commission upon the cross-appeals of respondents and counsel supporting the complaint from the initial decision of the hearing examiner, and upon the briefs and oral argument in support thereof and in opposition thereto, and the Commission having determined, for the reasons stated in the accompanying opinion, that the initial decision should be set aside and the complaint dismissed:

It is ordered, That the initial decision be, and it hereby is, set aside; and that the complaint be, and it hereby is, dismissed.

Commissioner Dixon not participating, and Commissioner Reilly concurring in the result.

Complaint

IN THE MATTER OF

THE AMERICAN ROLEX WATCH CORPORATION

CONSENT ORDER, ETC., IN REGARD TO THE ALLEGED VIOLATION OF
SEC. 2(d) OF THE CLAYTON ACT*Docket C-919. Complaint, July 21, 1965—Decision, July 21, 1965*

Consent order requiring a leading domestic distributor of watches, watch bracelets, watch accessories and related products in New York City, to cease discriminating among its competing customers in the payment of advertising and promotional allowances, in violation of Sec. 2(d) of the Clayton Act.

COMPLAINT

The Federal Trade Commission has reason to believe that the above-named respondent has violated and is now violating the provisions of subsection (d) of Section 2 of the Clayton Act (U.S.C. Title 15, Section 13), as amended; and therefore, pursuant to Section 11 of said Act, it issues this complaint, stating its charges in that respect as follows:

PARAGRAPH 1. Respondent The American Rolex Watch Corporation is a corporation organized and existing under the laws of the State of New York, with its principal office and place of business located at 580 Fifth Avenue, New York 36, New York. Respondent is one of the leading domestic distributors of watches, watch bracelets, watch accessories and related products, and its net sales during each of its fiscal years ended January 31, 1960 and 1961 exceeded \$1,000,000.

PAR. 2. Respondent has sold and distributed and now sells and distributes its products in substantial quantities in commerce, as "commerce" is defined in the Clayton Act, as amended, to customers located throughout the United States, many of which are engaged in substantial competition with each other in the resale of products purchased from respondent.

PAR. 3. Respondent's products are sold to consumers principally by retail jewelry and department stores. In each local trading area, all retailers handling respondent's products are engaged in substantial competition with each other in the resale of respondent's products as well as in the resale of products of other manufacturers. Such competition is characterized particularly by substantial expenditures by many such retailers for advertising in local media of general circulation, such as newspapers, radio and television, as well as for other forms of advertising, such as direct mailings,