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## Resale Price Maintenance and the FTC: The Magnavox Investigation

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# RESALE PRICE MAINTENANCE AND THE FTC: THE MAGNAVOX INVESTIGATION

VICTOR P. GOLDBERG\*

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## I. INTRODUCTION

Franchise agreements between a manufacturer and a distributor or retail dealer of the manufacturer's products often impose conditions on the dealer regarding items such as price, dealer location, service, and advertising. These vertical restrictions, whether price or nonprice, may violate the Sherman Act, which prohibits every contract, combination, or conspiracy in restraint of trade.<sup>1</sup> Whereas vertical price restrictions historically have been held *per se* invalid,<sup>2</sup> nonprice vertical restrictions have been permitted, subject to a rule of reason.<sup>3</sup> In *United States v. Arnold, Schwinn & Co.*,<sup>4</sup> however, the Supreme Court articulated a *per se* rule of illegality for nonprice vertical restrictions, which produced sharply contrasting results depending on the role played by the distributor in the product distribution system.<sup>5</sup>

Ten years later, in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,<sup>6</sup> the Supreme Court reversed the *Schwinn per se* rule and held that nonprice vertical restrictions would be subject to a rule of reason. The Court explicitly distinguished between price and nonprice restrictions: "As in *Schwinn* we are concerned here only with nonprice vertical restrictions. The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy." In his concurring opinion, Justice White questioned this:

I have a further reservation about the majority's reliance on "relevant economic impact" as the test for retaining *per se* rules regarding vertical restraints. It is common ground among the

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1. 15 U.S.C. § 1 (1976).

2. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

3. *Standard Oil Co. v. United States*, 221 U.S. 1 (1911). The Court, in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), explained the two varying methods of analysis. Under "the rule of reason," the factfinder weighs all the circumstances of a case, particularly the specifics of the challenged practices and their impact on the marketplace, in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. *Per se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive. *Id.* at 44, 49-50.

4. 388 U.S. 365 (1967).

5. *Id.* at 379.

6. 433 U.S. 36 (1977).

7. *Id.* at 51 n.18.

leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well . . . . The effect, if not the intention, of the Court's opinion is necessarily to call into question the firmly established *per se* rules against price restraints.<sup>8</sup>

There can be little doubt that Justice White's conclusion is correct. (His reservation is less convincing, however.) The arbitrary line between price and nonprice restrictions reflects a judicial naivete about the nature and economic effect of selective distribution systems. Indeed, the Schwinn marketing arrangement attacked by the Justice Department had price maintenance as one of its elements; following the decision, Schwinn continued to maintain prices.<sup>9</sup>

If (or when) the *per se* treatment of resale price maintenance (RPM) is reconsidered, it will be desirable to have a body of information on the role of RPM in selective distribution systems. One possible source is the Federal Trade Commission (FTC or Commission) files. In the 1970's the FTC brought charges against thirty-seven firms for engaging in RPM. Because RPM was illegal *per se*, the investigators did not directly develop evidence regarding its purpose and effects; in a number of cases the central issue was whether the methods used for enforcing RPM fell within the protection of the boundaries demarcated by *United States v. Colgate & Co.*,<sup>10</sup> and *United States v. Parke, Davis & Co.*<sup>11</sup> Nevertheless, the FTC files do contain potentially useful information, provided that the material can be organized in an accessible form.

This paper provides a distillation of the material in one of these cases—the Magnavox investigation.<sup>12</sup> The investigation produced

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8. *Id.* at 69-70. Laurence Popofsky, Sylvania's counsel, notes that "the careful footnote discussion in *Sylvania* appears intended to defer rather than resolve the issue." *Resale Price Restraints Revisited*, 49 ANTITRUST L.J. 109, 112 (1980).

9. *A Bill to Repeal the Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 125-40, 235-51 (1975) [hereinafter cited as *Hearings*].

10. 250 U.S. 300 (1919).

11. 362 U.S. 29 (1960). The investigation of Lenox was narrowly focused on precisely this issue. See Goldberg, *Enforcing Resale Price Maintenance: The FTC Investigation of Lenox*, 18 AM. BUS. L.J. 255 (1980).

12. Magnavox, 78 F.T.C. 1183 (1971). The FTC investigative file was Docket No. 8822

four cartons of documents. Although much of the material is directed at Robinson-Patman issues,<sup>13</sup> not price maintenance or selective distribution, there is enough relevant material to provide a fairly good picture of the nature of Magnavox's marketing system.

I have deliberately chosen to restrict this study to material available from the Magnavox files (with a few minor exceptions). Limiting the analysis in this manner serves the useful purpose of demonstrating the type of material that would be produced in a routine antitrust investigation and that would be available to the enforcement agency at the time and to scholars for subsequent analysis. On the negative side, this research strategy yields some gaps and ambiguities in the characterization of Magnavox's marketing arrangements. There is still, however, sufficient information to provide a confident judgment on the wisdom of pursuing this and similar cases in the future.

In section II, the history of the Magnavox investigation from the initial complaint to the acceptance of the consent order is presented. Following a brief description of the general retailing strategies of Magnavox and its competitors (section III), a detailed picture of Magnavox's marketing arrangement is given (section IV). In section V, Magnavox's techniques for enforcing RPM are described. A conclusion follows.

## II. HISTORY OF THE MAGNAVOX COMPLAINT

In December 1964, a manufacturer sent a letter to the FTC complaining that various California retailers had refused to carry its audio equipment because of pressure from Magnavox or Fisher Radio Corporation. The manufacturer included a letter to the firm from a former dealer which illustrates the type of behavior to which the manufacturer was objecting:

As you know Magnavox hasn't taken kindly to the progress . . .

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[hereinafter cited as File 8822].

13. Robinson-Patman Price Discrimination Act, 15 U.S.C. §§ 13a, 13b, 21a (1976). Under the Act, a seller may not directly or indirectly discriminate in the price charged purchasers of goods "of like grade and quality where the effect may be to injure, destroy or prevent competition with any person who grants or knowingly receives a discrimination, or the customer of either." L. SULLIVAN, *HANDBOOK OF THE LAW OF ANTITRUST* 677 (1977).

Nonetheless, the Robinson-Patman aspects of the Magnavox case are beyond the scope of this Article.

[your firm] has made with their dealers and this has been pointed out to me on several occasions.

If I was running this business for a hobby and not to make a living I would not make the decision to give up the . . . Franchise, but in as much as we derive most of our income from Magnavox Sales I have to act upon business and economic reasons rather than on principle alone. The reasons and plan presented to me during a five hour discussion with Magnavox the other day leaves me no choice but to give in and accept if I'm going to stay in this business.<sup>14</sup>

This complaint about exclusive dealing in audio equipment triggered an investigation which eventually resulted in a consent order concerning resale price maintenance in consumer electronic products (primarily television).

There is no doubt that Magnavox followed a policy of attempting to maintain retail prices and that this policy generally was successful. The FTC staff spelled out its primary objections to the Magnavox policy in internal memos supporting the issuance of a complaint (December 1969) and opposing the draft consent order proposed by Magnavox (September 1970). The policy, the staff argued, hurt Magnavox's competitors and certain of its dealers:

The most glaring inequity in the view of . . . [Magnavox's] competitors has been the "leverage" which Magnavox has been able to obtain with dealers because of its sole ability to guarantee them full profit margins. This advantage has been used to press its dealers for exclusive dealing arrangements, to tie-in sales of unwanted merchandise and to require dealers to carry a full line of its products. Conversely, the fact that the dealer is price protected motivates him to concentrate his efforts on, and to favor the sale of, Magnavox products over those of other manufacturers.<sup>15</sup>

. . . .  
The coercive sales maximizing practices attacked . . . have caused injury not only to certain of . . . [Magnavox's] own dealers, but more particularly to its competitors. Such injury to

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14. File 8822-4-2. The bulk of the material in Magnavox comes from unpublished files. Many of the documents in those files do not have page numbers, making it difficult to indicate the precise location of particular documents.

15. Staff recommendation, December 1969, pp. 113-14, File 8822-4-1.

competition is an inescapable consequence of those practices which logically follow . . . [Magnavox's] established policy of exploiting the market from a limited dealer base. Full profit margins may make for cooperative and reliable dealers, but cooperation and reliability should not be misread as indicating that Magnavox dealers have not been coerced and intimidated in running their own businesses or that their own competitive needs have not been subverted to those of Magnavox.<sup>16</sup>

. . . .  
Its ability to guarantee profits through price control has made respondent's dealer franchise one of the most sought after in the industry. Although there are about 100,000 dealers potentially available to respondent, its market strategy calls for a self-imposed limitation of somewhat over 2,000 dealers. The fact that no trading area is saturated with its dealers has also meant that no dealer is under compulsion to engage in hard competition with any of respondent's dealers.<sup>17</sup>

. . . .  
Although the consumer electronics products industry is characterized by low profit margins, generally Magnavox dealers have traditionally enjoyed the industry's highest profit margins.<sup>18</sup>

The FTC focused its concern on possible injury to competitors in the industry and franchisees, rather than on consumers. The franchisees were pictured both as being victimized and as being the beneficiaries of a system that provided the highest profit margins in the industry. This seeming anomaly can be rationalized if one realizes that the FTC is concerned with governing the franchisor's discretionary power vis-a-vis the franchisee. Nevertheless, these arguments reflected the uneasy accommodation of conflicting interests and analytical confusion that has characterized much of the legal treatment of vertical restrictions generally and resale price maintenance in particular.<sup>19</sup>

The initial complaint did not stimulate immediate action. FTC approval for a full field investigation was finally given on Septem-

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16. *Id.* at 110.

17. *Id.* at 106.

18. *Id.* at 107-08.

19. *See, e.g., Simpson v. Union Oil Co.*, 337 U.S. 13 (1964).

ber 6, 1966. The investigation was to determine whether

Magnavox is in violation of Section 5 of the Federal Trade Commission Act and Section 3 of the Clayton Act in connection with alleged exclusive dealing and full-line forcing and possible violation of Sections 2(a) and 2(d) of the Robinson-Patman Act in connection with proposed respondent's cooperative advertising program, volume rebate schedule and alleged discounts.<sup>20</sup>

On March 30, 1967, the FTC expanded the investigation to include an additional charge of unlawful price maintenance.<sup>21</sup> The focus of the inquiry shifted from audio equipment to televisions—the dominant element in Magnavox's product line. An internal FTC memo stated:

Attached is a copy of a Fair Trade Agreement which Magnavox required one of its dealers in a free trade area to sign as a condition of doing business. Furthermore, its dealers in non-fair trade jurisdictions report that their retail prices are constantly being policed by proposed respondent's sales representatives who examined invoices at will and threaten to terminate their franchises if they fail to adhere to list prices. Even in free trade areas, proposed respondent insists that discount houses who sell its products refrain from price competition and sell at list prices.<sup>22</sup>

In August 1968 the Commission and Magnavox explored the possibilities of settlement. Following the Commission's invitation to enter into discussions, Magnavox's counsel responded by presenting its proposed terms of settlement:

With respect to your inquiry regarding "resale price maintenance activities" in states which do not have valid fair trade laws (free trade areas), Magnavox would be willing to discuss the terms of a consent order concerning such free trade areas. We, of course, would wish to have included an express provision that in so consenting Magnavox would not be waiving its right to suggest retail prices for its products and to make a unilateral

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20. File 8822-4-1.

21. Correspondence with the Division of Compliance in March and April, 1965, questioned Magnavox's pricing policy in the states without fair trade laws. Magnavox was the subject of an earlier Justice Department investigation in 1962.

22. File 8822-4-1, p. 17.



announcement of its policies to its dealers, including policies affecting retail prices, and to refuse to deal with those who do not observe those policies.<sup>23</sup>

They also asked for a provision that would permit them to continue their fair trade activities in fair trade states.

The FTC staff concluded in September 1968 that an investigation should be undertaken on four issues:<sup>24</sup> (a) vertical price fixing enforced by a policy of refusal to deal which went beyond the *Colgate* doctrine;<sup>25</sup> (b) restrictions setting a maximum value for trading; (c) exclusive dealing contracts between Magnavox and the subset of their dealers designated Magnavox Home Entertainment Centers; and (d) possible Robinson-Patman violations inherent in the Magnavox discount structure. The staff also concluded that whatever full line forcing Magnavox might have engaged in did not violate the law. The bulk of the subsequent investigation consisted of dealer interviews and focused on Robinson-Patman issues; terminated dealers were not interviewed.<sup>26</sup>

The Magnavox counsel presented the FTC a draft consent order on August 13, 1970.<sup>27</sup> The FTC staff recommended against acceptance in a September 18, 1970 memo primarily because the proposed order would enable Magnavox to continue its resale price maintenance activities in those states in which fair trade laws existed.<sup>28</sup> The Commission filed its complaint on October 12, 1970.<sup>29</sup> However, the case never went to adjudication; a consent order was entered into on June 9, 1971.<sup>30</sup> A portion of it is reproduced in the Appendix.

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23. *Id.* at 108.

24. File 8822-4-1.

25. *United States v. Colgate*, 250 U.S. 350 (1919). In *Colgate*, the Court held that where a seller selects firms to deal with, his choice will not be deemed conspiratorial if it is made unilaterally. *Id.* at 307. That is, the seller must make the choice alone and not act "in concert either with other sellers or other buyers . . . ." SULLIVAN *supra* note 13, at 392.

26. The earlier Justice Department investigation did include interviews with terminated dealers, and these were available to the Commission. See File 8822-4-15.

27. File 8822-4-1.

28. *Id.*

29. *Id.*

30. *Magnavox*, 78 F.T.C. 1183 (1971).

A. *Magnavox's Proposed Consent Order*<sup>31</sup>

Under the proposed order, the FTC would have ordered Magnavox to cease and desist from a number of practices that had "the purpose or effect of fixing, establishing, maintaining, enforcing or, for a period of two years from the effective date of [the] Order, suggesting the retail prices at which Magnavox products were to be resold."<sup>32</sup> The first provision broadly proscribed Magnavox's ability to establish, maintain, or enforce "any plan or policy under which contracts, agreements, understandings or arrangements are entered into with the dealers"<sup>33</sup> which have price fixing as a purpose or effect. This was followed by twenty-one more specific proscriptions of particular practices. Because most of these terms were included in the final order (see Appendix) with little or no modification, I will not summarize them here.

Paragraph II restricted application of the order to those states (and the District of Columbia) which did not have fair trade laws. Since these free trade areas accounted for only about fifteen percent of Magnavox sales, this paragraph would have drastically reduced the impact of the order. Paragraph III of the proposed order prohibited Magnavox from engaging in exclusive dealing, full line forcing, or tying arrangements if these would "tend to create a monopoly, or . . . [have] the effect of substantially lessening competition."<sup>34</sup>

Paragraphs IV-VI applied to Magnavox's relations with its dealers, distinguishing between dealers in free and fair trade areas. Paragraph IV required that Magnavox offer reinstatement to any dealer terminated in a free trade area since January 1, 1966 unless the dealer "does not or did not at the time of termination have good credit or character, or . . . the dealer does not have reasonably adequate facilities for selling and servicing [Magnavox's] products."<sup>35</sup> Paragraph V required that Magnavox inform all existing dealers, future dealers (for three years after the order became effective), and all dealers in free trade states terminated since Janu-

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31. File 8822-4-1. This is a 12 page document.

32. *Id.* at 1.

33. *Id.*

34. *Id.* at 6.

35. *Id.* at 8.

ary 1, 1966 of the terms of the order. Paragraph VI required Magnavox to reassign its sales personnel so that none of its regional managers would have administrative responsibility over dealer locations in both fair and free trade areas.

In his Memorandum in Support of the Proposed Order, Magnavox's counsel argued that, in regard to the free trade areas, the order adopted "provisions more far reaching and complete than those included in any litigated or consent order."<sup>36</sup> He also claimed that the FTC's desired remedy exceeded its authority as delineated by the court of appeals in *Lenox, Inc. v. FTC*.<sup>37</sup> Counsel also argued that allowing Magnavox to continue its RPM in fair trade states would promote competition in the electronics market, particularly color television, because it enabled Magnavox to compete better against the industry giants—RCA and Zenith. Furthermore, disallowing RPM in those states would injure dealers who had relied upon the continued existence of the practice.<sup>38</sup>

#### B. *The FTC Complaint*<sup>39</sup>

Accepting the FTC staff's advice to refuse a settlement which applied only to non-fair trade states, the FTC filed its complaint. The FTC's proposed order differed in only a few areas from the Magnavox proposal. The terminated dealer provision was extended back to January 1, 1962, and included all dealers, not just those in free trade areas. The primary difference, however, was in the application to fair trade states where the proposed order now was to be applied

regardless of whether or not the acts and practices therein specified are otherwise lawful under the statutes, laws or public policy now or hereinafter in effect in any state or territory or in the District of Columbia, provided, however, that the application of said provisions shall terminate in jurisdictions in which the specified acts and practices are otherwise lawful upon a showing by respondent, subject to approval by the Commission, (a) that the specified acts and practices have not been used by respon-

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36. *Id.* at 5.

37. 417 F.2d 126 (2d Cir. 1969).

38. File 8822-4-1, pp. 8-10.

39. Magnavox Co., Docket No. 8822, Complaint, October 12, 1970, File 8822-4-1.

dent during the preceding 24 months, and (b) that respondent is in compliance with the provisions of Paragraph III of this Order.<sup>40</sup>

That is, Magnavox would have to agree not to use resale price maintenance in all jurisdictions for at least two years. The proposed order also eliminated the "tendency to create a monopoly" language from Paragraph III.<sup>41</sup>

### C. *The Negotiations*

On February 4, 1971, Magnavox filed, with the approval of the Bureau of Competition, a motion for withdrawal from adjudication. Four days later it filed a confidential memorandum in support of that motion and a revised proposed order.<sup>42</sup> Magnavox suggested that its earlier proposal had been based on its incorrect understanding that the sole issue separating it and the FTC was whether it "should be required to abandon its entire lawful fair trade program for a period of two years to remedy the alleged retail price violations in non-fair trade jurisdictions."<sup>43</sup> Pretrial discussions with the Bureau of Competition showed that the Bureau also felt that the proposed relief provisions undermined *Schwinn* "in that they might be construed to permit respondent to limit the freedom of dealers to resell respondent's products."<sup>44</sup> Magnavox also argued that unilateral changes in its marketing system were sufficient to make further relief unnecessary.

The *Schwinn* problem was remedied by a minor rewording. The proposed clause, with additions italicized and deletions in brackets, required that Magnavox cease and desist from:

*[t]erminating, harassing, threatening, intimidation, coercing or delaying shipments to any dealer because [of respondent's belief*

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40. *Id.* at 10. Paragraph III referred to exclusive dealing, full line forcing, and tying.

41. The proposed order was silent on the internal organization of Magnavox's sales network because it presumed that there would be no areas in which Magnavox could utilize resale price maintenance.

42. A transcribed prehearing conference was held January 14, 1971; the record is not public.

43. Memorandum in Support of Motion for Withdrawal From Adjudication and Entry of a Consent Order, February 8, 1971, p. 5, File 8822-4-1 [hereinafter cited as Motion for Withdrawal].

44. File 8822-4-1, p.6; see *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

that] the dealer has sold or is selling its products at other than its established or suggested retail prices or to any [of respondent's] other dealers or distributors of *consumer electronic products*.<sup>45</sup>

The initial Magnavox proposal exempted all states in which fair trade was legal, while the Commission's proposed order would have applied to all jurisdictions. Magnavox objected on the ground that such an order would be unduly punitive. The negotiations brought out the Bureau of Competition's concern that the narrow remedy might not adequately handle problems arising at the border between jurisdictions with different laws. Dealers might have outlets in both free and fair trade jurisdictions; moreover, free and fair trade outlets would be competing in the same markets. To fine-tune the remedy, Magnavox undertook a determination of the extent of the overlap problem. There were only eight Standard Metropolitan Statistical Areas (SMSAs) in which the overlapping jurisdiction situation existed and only one—Washington, D.C.—in which it was a serious problem, Magnavox claimed. (Of the six Magnavox dealers there, five—accounting for over ninety percent of its total sales—had outlets in both free and fair trade jurisdictions.) Magnavox accordingly agreed to extend the ban to the fair trade portions of the Washington D.C. SMSA. The Bureau, however, felt this was inadequate and Magnavox then agreed to an extension of the prohibition to all SMSAs crossing jurisdictional lines in which there was at least one non-fair trade dealer in Magnavox products.<sup>46</sup> The final order extended this further, eliminating the requirement that Magnavox have at least one free trade dealer in the area.

In its Memorandum in Support of the Motion for Withdrawal from Adjudication, Magnavox summarized a number of changes in its marketing structure and practices.<sup>47</sup> These included a realignment of its management structure so that zone and regional managers dealt exclusively with a fair or free trade jurisdiction; further, the two groups reported to different individuals at the national

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45. Comparison of Relief Provisions (an Appendix to Motion for Withdrawal, *supra* note 43), p.5, File 8822-4-1. The final order added an additional clause.

46. *Id.* at 7-10.

47. *Id.* at 12-16.

level. (Magnavox estimated the annual additional salary cost at \$240,000.) Sales bulletins and letters to dealers were prepared in two versions—one for fair trade and the other for non-fair trade jurisdictions. Retail price was no longer mentioned in national advertising, and Magnavox ceased issuing guidelines on trade-in allowances. The franchise contract in non-fair trade states was revised to read that the dealer shall:

Advertise, promote, offer for sale, sell or otherwise deal in Magnavox electronic home entertainment products at prices which shall be determined solely by you. Any agreement or understanding to the contrary, whether written or oral, expressed or implied, formal or informal, is unauthorized and in conflict with Magnavox policy . . . Magnavox will not entertain complaints about the pricing practices of other dealers in Magnavox products.<sup>48</sup>

#### D. *The Consent Order*

The final order had few differences from that proposed in February. Paragraph I added a clause that moderately increased the restrictiveness of the order. Thus, Magnavox's prohibition on encouraging or paying rewards to dealers for information on the price-cutting of other dealers was extended to include information on the identity of the customers of the price-cutting dealers. Another change in the order was a slightly broadened definition of overlapping market areas favored by the Commission. The final order adopted Magnavox's proposed date for extending the right of reinstatement to previously terminated dealers.

The order directed Magnavox to send a letter to all its existing dealers in the affected jurisdictions informing them of the terms of the consent order. It also required that a copy of the order and a cover letter be sent to each new franchised dealer in the three years after the effective date of the order. Those Magnavox dealers terminated after January 1, 1966 were to receive within thirty days copies of the order and a cover letter informing them that they

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48. *Id.* at 14. Discussing the consent order before a national sales meeting in April 1971, a Magnavox executive characterized the firm's strategy as "to make the changes and then to say to the Commission, 'In fact we have done it. We have demonstrated to you our good faith; now get off our backs.'" File 8822-2.

could apply for reinstatement. For the two years following the effective date of the order, Magnavox was required to report the names and addresses of all dealers in free trade areas terminated in that year and the reasons for their termination. The Commission did not require Magnavox to submit any data concerning prices or sales of Magnavox products, thus making it impossible for the FTC to compare results in free trade and fair trade areas.

### III. THE RETAILING STRATEGIES OF MAGNAVOX AND ITS COMPETITORS

Magnavox was the third largest seller of color televisions with a market share of 9.2% in 1965-1969; its shares of other consumer electronic goods markets were smaller. The industry leaders, RCA and Zenith, had twenty-seven percent and twenty-two percent of the color television market respectively.<sup>49</sup> Although most of its competitors utilized unselective distribution systems, Magnavox followed a longstanding policy of limited distribution and uniform retail pricing. The strategy was summarized in a 1957 letter from Frank Freimann (Magnavox president until his death in March 1968) to dealers:

Magnavox does now and has successfully in the past, administered its policy of a uniform national retail price in such states as Texas, Missouri, Vermont—and even Washington, D.C.—where Fair Trade Laws are not valid.

. . . .

The Magnavox merchandising policy now in existence was conceived and executed in 1938 . . . . [W]e did not avail ourselves of the "protection" of the Fair Trade Laws . . . until 1948 . . . . Should the Fair Trade Laws be repealed—and we doubt that they will be—it will have no more effect on our ability to maintain the same orderly retail selling policy which we have operated so long than it had been before the Fair Trade Agreements were signed—that's because we have the *will* and the determination to maintain such a policy.<sup>50</sup>

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49. National Committee on Product Safety, January 27, 1970.

50. File 8822-4-1, p. 108. A 1959 Magnavox memo to dealers stated: "Magnavox is the only line that is fair traded in every state with fair trade laws but is administered just as effectively in states which do not provide protection against annihilating competition." File 8822-4-14-3, CX 135.

The standard Magnavox franchise agreement stated: "Dealers will be geographically located so as to provide easy customer access to our products, and yet be so limited as to give Magnavox franchised Dealers a minimum of dealer competition with a maximum sales potential per Dealer."<sup>51</sup>

In over half the cities in which Magnavox products were sold there was only one dealer, but most of these single dealer cities were small. A 1965 internal document showed the number of Magnavox dealers advertising in newspapers throughout the country. The cities were classified in three groups: Type I Markets were the largest cities (although it included such cities as Griffin, Georgia with a 1970 population of 22,734), and Type III were the smallest. Table I in the Appendix shows the number of one-dealer cities by market type.<sup>52</sup> Table II shows the number of dealers in the different markets, suggesting the small number of dealers in most markets. Table III provides a breakdown of the totals for those cities with seven or more dealers. The figures are somewhat misleading because neither markets nor newspaper circulation territories follow city boundaries. No doubt many of the advertisers in the *Los Angeles Times* were located outside the city and were aiming their advertisements at a subset of the customers. Nevertheless, the figures do give a reasonable picture of the semi-exclusiveness of the franchise.

Although most other manufacturers used independent distributors to reach a large number of retailers, Magnavox maintained a smaller number of dealers and dealt with them directly. In a 1964 letter to dealers, Freimann noted that Magnavox had 3338 dealers while one of its "prime competitors boasts 40,000 dealers."<sup>53</sup> The FTC staff noted:

Few, if any, of its competitors, have tried to select their dealers with more care or to control their sales activities more closely than has Magnavox. To the extent that it can do so, . . . [Magnavox] keeps distribution to its dealers entirely in its own

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51. File 8822-4-1.

52. The figures cover dealers who advertise in the cities. Since outsiders can advertise in the city and since some dealers might use no advertising, the text statement is not strictly correct.

53. File 8822-4-5-1, pp. 71-73.



hands. Only in Alaska or in foreign countries has Magnavox been forced to sell its products to dealers through independent distributors.<sup>54</sup>

As a matter of policy Magnavox generally "elected not to franchise retailers who hold themselves out to the public as discount houses."<sup>55</sup>

The nature of the marketing system of the competitors is best summarized by the court of appeals majority decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*:

During the so-called black and white era, most television manufacturers engaged in a relatively unselective "saturation" method of distribution. Essentially, this system involved the sale of television sets both to independent and manufacturer-owned distributorships, without any limit on the number of dealers in a given locale. The goal of such a system was to generate as much volume as possible; therefore, manufacturers sought to sell as many dealers as possible.<sup>56</sup>

That decision also credited Magnavox with pioneering selective distribution in the late 1950's.<sup>57</sup>

The record, however, is a bit muddy on the marketing practices of the Magnavox competition. Thus, in its Memorandum in Support of the Motion for Withdrawal from Adjudication, the Magnavox counsel asserts:

Every major industry member, including RCA and Zenith, either directly or through its distributors, utilizes fair trade programs to some degree. A complete ban of the right to fair trade, even for a limited period of time, seriously threatens Magnavox's competitive position. Magnavox is legitimately concerned that many dealers—who deliberately select merchandise because of the availability of fair trade programs—will discontinue or substantially deemphasize Magnavox in favor of competing brands which they can fair trade.<sup>58</sup>

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54. Staff Recommendation for Issuance of a Complaint, December 23, 1969, p. 107, File 8822-4-1.

55. Letter from Magnavox counsel, January 13, 1968, p. 40, File 8822-4-3-2.

56. 537 F.2d 980, 982 (9th Cir. 1976).

57. *Id.* at 983.

58. Motion for Withdrawal, *supra* note 43, p. 4, File 8822-4-1.

Nevertheless, it is reasonable to conclude that, with the exception of Sony,<sup>59</sup> Magnavox's program of dealer "elbow room" and resale price maintenance was generally not followed by the industry, especially in the non-fair trade jurisdictions.<sup>60</sup>

The Magnavox resale price maintenance program was, therefore, somewhat of an aberration in the industry. Consequently, one can conclude that Magnavox's RPM policy was not an element of a broader industry attempt at cartelization. Nor was Magnavox the reluctant cat's paw of a dealer cartel. Magnavox's successful enforcement of the policy in free trade areas (and in the entire country in the decade in which it did not avail itself of the protection of the fair trade laws) seems dispositive on that count.

#### IV. THE MAGNAVOX RETAILING SYSTEM

Although resale price maintenance was the central element in the Magnavox retailing strategy, it was not the only element. Magnavox, unlike most of its competitors, aimed for a segment of the market and relied heavily on dealer selling efforts to move its product.<sup>61</sup> Magnavox employed a number of inducements and sanctions for directing dealer effort. Some of these tools were ancillary to RPM, but others were not. This section will describe the retailing system in detail and will suggest reasons why Magnavox chose to structure the relationship in the manner in which it did. Finally, it will show why retailers might have found the overall arrangement attractive.

Price maintenance and restricted distribution can be used to protect or enhance the quality image of a product, to induce the provision of retailing services, and to screen retailers. This section will begin with a discussion of these elements and then consider

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59. See Ingrassia, *In a Color-TV Market Roiled by Price Wars, Sony Takes a Pounding*, Wall St. J., March 16, 1978, at 1, col. 6.

60. Sylvania's "elbow room" policy did not utilize resale price maintenance. Instead, it provided protected territories to its dealers by franchising them to operate only from approved locations.

61. Magnavox also absorbed freight costs. The price to the dealer consequently was the same in all markets. The retailer margin varied over the product lines, with the stereos generally having the greater mark-up. In 1967, the margins ranged from 20% to 43%. File 8822-4-5-2, pp. 833-39. In 1966, eight console radio-phonographs had a margin of 48%. File 8822-4-5-3, p. 655.

the nature of the "free rider" problems that arise in retailing and how the Magnavox system dealt with them. The discussion will be somewhat impressionistic because the FTC investigation was not concerned with these matters and systematic evidence on them was not gathered. The following subsections will describe other aspects of the retailing system.

#### A. *Quality and Dealer Service*

Magnavox concentrated its product line and selling effort on the more expensive items: large screen televisions, television/stereo combinations, and television-as-furniture units. In 1959, for example, twenty-three percent of Magnavox's television sales came from twenty-four inch models, while the industry average was only four percent.<sup>62</sup> Half of Magnavox's color television dollar volume in 1966 came from combination stereo units; Magnavox accounted for thirty-eight percent of sales of such units despite its much smaller overall market share.<sup>63</sup> While the market the company aimed at can be characterized as the "quality" market, this label is somewhat misleading. The quality of Magnavox products was not judged particularly high by *Consumer Reports* in 1960-1970. A summary of the findings is presented in Table IV in the Appendix.

One interviewed dealer stated that "price maintenance adds to the prestige of an item which is offered for sale."<sup>64</sup> He went on to argue that if the firm had "wanted to wheel and deal on resale prices it would sell a line of merchandise which is conducive to such activity."<sup>65</sup> A second dealer linked the quality image more to the nature of the dealers than to their practice of price maintenance. He was "mostly concerned with the character of stores

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62. File 8822-4-14-3, CX 119.

63. File 8822-4-5-2, p. 513. Although these units accounted for half of Magnavox's dollar volume, they accounted for only 35% of the units.

64. File 8822-4-3-12, p. 1398. At the Senate hearings on repeal of fair trade, a Magnavox dealer testified:

It has been my observation that the majority of manufacturers availing themselves of the present fair trade laws have become the most respected in their fields. That's why I sleep on a Simmons mattress, my wife rides a Schwinn bicycle, we watch a Magnavox television set, use a Sunbeam mixmaster in the kitchen and seed our lawn with Scotts.

Hearings, *supra* note 9, at 98.

65. File 8822-4-3-12, p. 1398.

where Magnavox merchandise was sold because [he] was interested in presenting a quality picture to the consumer and would not be able to do so unless competing Magnavox dealers did so also.”<sup>66</sup>

A Magnavox vice president testified in the 1975 Senate hearings on the repeal of the fair trade laws:

We sell our products to our dealers at the same prices in all States, so one can rightly ask, “Why does Magnavox care about the price at which its dealers resell?” Our interest is pure and simple. We desire that our product be sold by dealers who will do more than show the consumer a picture in a catalog or load a television set in a consumer’s station wagon in the original factory carton.

We have elected to compete on quality which, because of the nature of the product and our method of distribution, requires a combined effort of ourselves and our dealers.

We expect and insist that our dealers preservice our product before it is sold to a consumer, and we obtain dealer support for this consumer benefit by means of selective distribution and the utilization of fair trade, where legal, to insure a fair profit to the dealer.<sup>67</sup>

He went on to suggest an additional advantage of resale price maintenance to Magnavox: fair trade enables it to attract the best dealers. “There is a very high correlation between the finest merchandisers in town, the most respected over a long period of time, and Magnavox dealers; those are the people we attract because our philosophy fits with their philosophy and they like fair trade.”<sup>68</sup> This argument is to some extent self-serving; it can be restated in a more neutral fashion. Those dealers whose comparative advantage is in service-intensive retailing methods will be attracted to manufacturers using restricted distribution marketing systems. It would be surprising to find that RPM is a more effective tool for identifying and attracting those retailers than other restricted distribution arrangements (for example, exclusive territories).

The Magnavox distribution setup relied on dealers to provide

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66. *Id.* at 1443. This dealership had carried Magnavox since 1938. In 1966 it took on the Sylvania line (another restricted distribution system) and shortly thereafter discontinued its Magnavox line. *Id.* at 1442-43.

67. *Hearings, supra* note 9, at 94.

68. *Id.* at 100.

various pre- and post-sale services: display, advertising, repair, speed of delivery (maintaining a substantial inventory), and so forth. The terms of the agreements between Magnavox and the dealers suggest some of the elements of this selling strategy. These agreements are only suggestive because they are not interpreted literally; indeed, a number of franchisees interviewed couldn't even find their copies of the franchise agreements. Nevertheless, a pattern does emerge which is consistent with other evidence. In accepting the franchise agreement, the dealer agreed to "maintain . . . a representative display of current Magnavox models equal to or greater than any competitive make, . . . [and] to maintain at all times a reasonable back-up stock to allow for continuity of sales."<sup>69</sup> In addition, he agreed to provide customer service and use various Magnavox suggested sales aids, such as contests.<sup>70</sup> If the franchisee chose to use the Volume Incentive Plan,<sup>71</sup> he agreed to a number of additional conditions. The dealer had to "display and promote Magnavox products . . . in every product line" provided he trafficked in such products.<sup>72</sup> The dealer was required to "participate in the Magnavox Retail Sales Incentive Program which [was] designed to stimulate the sale of Magnavox higher quality, higher priced products."<sup>73</sup> The agreement also stipulated that "in no case [was] the dealer to compensate the salesmen on competitive merchandise at a *higher* rate than paid for selling Magnavox."<sup>74</sup> Other conditions referred to sales training provided by Magnavox to the dealer's sales personnel, customer service, repairs policy, and the availability of facilities for demonstrating Magnavox's products (listening rooms, demonstration records, and an adequate source of television signals).

In another supplemental agreement for franchisees who carried the Imperial line of stereo equipment, Magnavox added some additional duties. Thus, in addition to the normal expectations concerning service, the dealer also was to "agree to service the Imperial Series models in the home immediately after delivery to assure

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69. Magnavox Franchise Agreement, 1968, File 8822-4-1.

70. *Id.*

71. See notes 100-117 & accompanying text *infra*.

72. File 8822-4-14-3, CX 164.

73. *Id.* CX 16.

74. *Id.*

they are properly functioning, properly prepared for use and to provide detailed customer instruction.”<sup>75</sup> The dealer also was “to encourage its sales personnel to attend local meetings which are sponsored by the Magnavox District Manager at intervals, . . . utilize sales training materials, [and] [a]ppoint one retail salesman to become the expert on the Imperial Series to assist in training the other retail Salesmen in the dealership.”<sup>76</sup>

The extra services argument was presented by a Magnavox dealer at the 1975 hearings on the bill to repeal fair trade:

Mr. JORDAN. . . . [W]ith Magnavox, . . . the customer can decide which dealer he feels is going to give him the best service and, of course, this is what we really try to provide. We don't charge extra or make a person carry their product home with them; it is pretested, checked, serviced, cabinets inspected, so that the customer really gets what he came into the store to purchase.

Senator HART. Why would you not be able to conduct your business in that fashion even if it was a nonfair traded set?

Mr. JORDAN. Well, we had experience with that previously and it just was not possible—you require a certain amount of margin in order to pay your help, pay for the additional services that are required. We hire two people to set up and make deliveries. Now on the basis of cut-rate or a discount price, we have to hire an outside trucking concern, we put a television set on that truck and it rides around town for 5, 6, 7, or 8 hours, and even though it may have been adjusted beforehand, this upsets the balance of the receiver and the quality is not the same.

It does cost just a little bit more to merchandise equipment in this manner, but the customer is purchasing, when he purchases a television set, not just the box with so many parts in it; he is buying the picture; he is buying definition; he is buying a quality of color.”<sup>77</sup>

A 1961 letter from Magnavox President Freimann to dealers suggests that, while service was their comparative advantage, Magnavox dealers had in the late 1950's allowed post-sale service

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75. *Id.* CX 4B. The agreement is for 1964. A 1967 agreement with minor changes in wording is included at CX 4.

76. *Id.* CX 4B.

77. *Hearings, supra* note 9, at 99.

to slip and that this was a reason for Magnavox devising its Gold Seal warranty:

We have been going through a degeneration in selling and servicing for several years. To circumvent some of the malpractices that have existed in the past we developed our Gold Seal service program five years ago. Every franchised Magnavox dealer has experienced its benefits even though there was resistance to it from some quarters initially.<sup>78</sup>

The warranty of ninety days for service and one year for parts was adopted widely in the industry. Magnavox paid for that by allowing the dealer an increased margin of fifteen dollars, which Freimann characterized as generous. In April 1961 the warranty for models with retail prices starting at \$279.50 was increased to twelve months on service with the margin being increased to twenty dollars for televisions and twenty-five dollars for Stereo Theatre combinations. Freimann continued:

We are aware there will be some resistance to our new plan—there would be, regardless of how high the service allowance might be—because some service organizations and self-servicing dealers feel they are deprived of the opportunity of making a “charge” at their own discretion after the 90 day warranty has expired.

In many quarters there has been a practice, in good conscience, of recapturing profits lost by price cutting, through service. This does not enter into the Magnavox philosophy of doing business and shouldn't in yours.<sup>79</sup>

Although the letter indicates Magnavox's belief that the dealer's “average cost will be well within the allowance,”<sup>80</sup> data are not available in the record to confirm this.<sup>81</sup>

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78. File 8822-4-14-3, CX 1164.

79. *Id.*

80. *Id.*

81. For a complete listing of the various Magnavox warranties available in 1965, see File 8822-4-5-1, p. 444. A number of the terminated dealers interviewed by the FBI complained about Magnavox's inadequate compensation for warranty work:

He is opposed to the Magnavox warranty policy which was issued in April, 1961. He feels that the terms of this policy remove the customer from the service field as a source of income to the dealer for a prolonged period of time. If the dealer received its regular service rates this would be satisfactory, but

### B. *The Free Rider Problem*

There are two fundamental free rider problems in retailing. First, retailers have an incentive to let other retailers expend resources on display, marketing, and advertising and then to "steal" the customers these activities develop by offering lower prices (or otherwise attractive terms). Second, the retailer can profit by shading quality if the loss of goodwill is borne primarily by the manufacturer or other dealers. Any retailing program that relies on dealer effort will have to find devices for coping with these problems.

My discussion will deal primarily with the former problem, but it is worth noting that the Magnavox system did take the second problem into account.<sup>82</sup> Introduction of the Gold Seal warranty can be interpreted in this manner. With dealers free to determine the price of repair work, they can make short-term profits while decreasing the likelihood that the customer's next purchase will be a Magnavox. Moreover, if the dealer fails to fix the product, the consumer is unsure whether the fault lies with the dealer or whether the product is a lemon. With the warranty, the dealer has a stronger financial incentive to determine whether or not the product is indeed a lemon.

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Magnavox's allowance to the dealer is quite insufficient.

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They also had much aggravation with the Magnavox Authorized Service Company, which it was mandatory they use inasmuch as they had no service department of their own. The Magnavox allowance on repairs was ridiculously low. Goods received in a damaged condition were the dealer's responsibility.

....  
The only other complaint he had concerning the company was a complaint that other dealers also had was the matter of the company policy as it related to picture tube warranty. He stated the company guaranteed a picture tube for 16 months from the date of shipment from the factory and that if the set remained in stock more than four months the dealer had to absorb the time to give the customer a full 12-month warranty whereas other manufacturers were more lenient concerning their warranty to dealers as well as to customers.

File 8822-4-15.

82. In the context of the *Magnavox* case, the quality shading problem probably is confined to the manufacturer-dealer relation. The dealer-dealer problem is worse in cases in which customers are transient and will respond to a bad experience with franchisee *X* by not patronizing *Y* in another area, such as in the restaurant and motel businesses. Problems could arise in the Magnavox context if dealer *X* sells a television and *Y* must provide the warranty work, but that does not seem to have been a problem.



If a dealer has a strong association with Magnavox and few alternative sources of Magnavox products are available to his customers, the greater the effect will be on that dealer of actions that might discredit the Magnavox name. Thus, it is not unreasonable to expect Magnavox to pay more to dealers specializing in the Magnavox line. *Ceteris paribus*, we would expect that Magnavox would pay more to retailers (grant larger discounts) if they specialized in the Magnavox line. Further, by limiting the number of dealers in an area, Magnavox reduced the likelihood that a dealer would shift the costs of low quality performance to other Magnavox dealers. Although Magnavox did grant larger discounts to those dealers carrying the entire Magnavox line<sup>83</sup> and did limit the number of dealers, it would be a great mistake to argue that the reason suggested here is the exclusive (or indeed primary) reason. Nevertheless, both factors should be expected to have some independent influence on the structuring of the Magnavox franchise relationship.

The record provides a few instances of claims of sales lost by dealers to price cutters:

I would judge that in the last year or two we have lost several thousands of dollars worth of business in Magnavox products because we have been complacent about our competition underselling us. We have had many loyal customers shop the Magnavox line in our store and leave without buying, and then we have discovered that they bought elsewhere.<sup>84</sup>

. . . .

We have in the past year sold approximately eight Magnavox instruments to our regular customers, who after anywhere from one day to ten days, have called us and have told us they can purchase the same set from a friend employed at [a competitor] for 15% below the retail price.<sup>85</sup>

A general explanation of the price undercutting strategy is put nicely by a 1959 Magnavox Confidential Dealer Bulletin aimed at dealers carrying more than one brand. The writer quoted a sales

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83. See notes 92-93 & accompanying text *infra*.

84. File 8822-4-14-3, CX 145.

85. *Id.* CX 121. It should be noted that Magnavox officials believed that this dealer had a tendency to overreact. See *id.* CX 128.

person for a large discount store as saying:

We handle all lines but can't display them all. If you desire X, Y, or Z brand, I suggest you go down to X, Y, or Z stores and select the model number and finish and then get the suggested retail price. This is the price the distributor puts on the set and then just call us back . . . [W]e can make delivery and at that time notify you of your discount price which will range from 15% to 25% off.<sup>86</sup>

From this the Magnavox representative drew the following moral:

You are leading stores in the public mind in your various communities and your endorsement of these discounted lines leads ultimately to this end.

1. You are establishing a price from which the discounter starts cutting.
2. You loan your store's prestige to these discounted lines.
3. Your displays and showrooms and your sales people are giving free sales presentations to the discounters.
4. You are discouraging your own sales people who are losing their time and sale presentation to the discounter.
5. You are tying up capital and slowing down turnover that is needed in your Magnavox line in better displays (which is quite mediocre in most cases), an adequate back-up stock which in most cases, is far too weak.
6. Your advertising dollars spent irrespective of distributor participation are being capitalized on by the multitude of other business houses with the same lines even disregarding the discount houses.<sup>87</sup>

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86. *Id.* CX 154. The author noted that the sales person stated that the discounter did not care to handle Magnavox, presumably because Magnavox polices this sort of behavior more effectively.

87. *Id.* The author then exhorted the dealers to switch from these other lines and concentrate their attention on Magnavox:

If you get in the Magnavox business right and stop endorsing these discount lines, here's what we will do for you.

1. Actually reduce inventory, less capital tied up where it isn't actually building for your future well-being.
2. Mark downs reduced and fewer samples sold off the floor.
3. Service costs reduced because of more efficient service and Magnavox Gold Seal program.
4. Far fewer sales will be lost outright and due to better back-up stocks and better line coverage, you can make deliveries.

One strategy for coping with this problem is to have the individual dealers provide fewer marketing services and instead rely on the manufacturer's advertising. Indeed, that was the basic strategy of most of Magnavox's competition. Resale price maintenance is a second strategy. If the producer sells through all dealers regardless of location, the dealers have an incentive to engage in certain forms of non-price competition, those for which the rewards can best be captured by the individual retailer. Specifically, in-store promotions and granting the product the relatively more attractive shelf space would be manifestations of this. The local retailer would have little incentive to advertise the product because the benefits of that advertising would be spread over a large number of retailers. Magnavox, however, coupled resale price maintenance with a limited distribution policy through which a dealer could expect to meet competition from only a small number of dealers carrying Magnavox. This made local advertising relatively more attractive to its dealers. Because Magnavox dealers often did not have truly exclusive territories, there was still some room for free riding on local advertising. By paying for some of the advertising through the cooperative advertising fund,<sup>88</sup> Magnavox, in effect, lowered the relative price of local advertising, in part offsetting the retailer's incentive to free ride in this dimension.

Rather than providing more services, a dealer can respond to an RPM policy in another way. He can shade his price. A fixed price, whether the fixing is done by a cartel, a manufacturer, or government price controls, can be undermined by many devices. If the firm cannot police the system effectively, the RPM/dealer-services strategy will not succeed. I will discuss in detail in section V Magnavox's use of termination, threat of termination, shopping of suspect price cutters, and other aspects of their policing. Here I want to stress an obvious point that is too often missed. Dealers

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5. Advertising is for yourself—more consistent and therefore more effective.
  6. Salesmen are more effective as they need only effectively train in one line and let's face it—what a salesman knows best, he sells best.
  7. Positive selling can be used as a salesman doesn't straddle the fence between lines.
  8. Sales training is more effective and less confusing.
  9. Reduced lines decrease the buying load for the store.
88. See notes 94-99 & accompanying text *infra*.

have a collective interest in having Magnavox police them to prevent them from following their short-term interests at the expense of their long-term interests.

If the agreement is being policed, dealers may resort to numerous devices to obscure hidden price cuts. One device often observed in other contexts is for the seller to tie the product to something else provided at a low, or zero, price. Magnavox did not allow retailers to give trading stamps on its products,<sup>89</sup> nor did it allow dealers to sell Magnavox products as part of a package deal or to "give away" free records or other items to Magnavox purchasers. A closely related avoidance device is to give purchasers a rebate on trade-ins. In 1961, Magnavox, after discussion with its dealers, issued a trade-in schedule which established how much a dealer could offer. "The schedule is a guide. It is my firm belief that it's [sic] instrumentation and your compliance with it will aid our volume and your profits. Any overallowance will be considered a discount and therefore a breach of your franchise agreement."<sup>90</sup>

Another form of avoidance is to reclassify a customer into a group that can receive a discount. Because Magnavox sold directly to retailers, that option was rarely available, although the record provides evidence of one instance of this ploy. A detective hired by a Magnavox dealer reported the following exchange with a dealer:

When I asked him if I could obtain a discount by working through a decorator, he smiled and said, "Do you have a decorator?"

When I replied that I did, he told me that, if I had the decorator contact him, he would be able to work out a discount with the decorator. At this point I told him that I would be interested in the set if I could get the set for approximately 10% discount. I further explained that my decorator would charge me the cost of the set to him, plus 5%, which meant that, in reality, he would have to give the decorator a 15% discount in order for me

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89. A Washington dealer which advertised itself as a discount house and which gave trading stamps on all other purchases, gave neither discounts nor stamps on Magnavox products. File 8822-4-3-10, pp. 1289-93. However, the dealer interviews uncovered one St. Louis retailer who was allowed to give stamps on Magnavox products—the stamps were equivalent to a two to four percent discount on the purchase price. File 8822-4-1-15, p. 1901.

90. File 8822-4-14-3, CX 119. A Milwaukee dealer stated that "the Magnavox trade-in schedule was a good thing since it was an effective means of price control." File 8822-4-3-6, p. 662.

to get the set at the price I wanted to pay.

He agreed that this amount of discount could be gotten and said, "Have your decorator contact me and I'll work out the deal with him." He further added that this discount method of operation was the most satisfactory for all concerned.<sup>91</sup>

### C. *Other Elements in the Magnavox Retailing System*

About 250 of the over 3000 Magnavox dealers were designated Magnavox Home Entertainment Centers (HECs). An HEC was required to devote a minimum of 1500 square feet of floor space to Magnavox products, to carry a full line of Magnavox products, and to not carry competing brands.<sup>92</sup> A dealer with multiple outlets, however, was required to be an exclusive Magnavox dealer only in the outlets designated as HECs.<sup>93</sup> The HEC received favored treatment under the cooperative advertising plan. This favored treatment was a major concern of the Commission field investigators. A substantial amount of the material collected and a large portion of the dealer interviews were concerned with showing that the favored treatment constituted a Robinson-Patman violation.

#### 1. *Cooperative Advertising Fund*<sup>94</sup>

Magnavox agreed to share the costs of some portion of the dealer's advertising provided that the advertisement was approved by Magnavox. Funds would accrue in a "cooperative advertising account," and Magnavox would use those funds to match the retailer's expenditures at a specified matching formula. The arrangement had four rates at which cooperative funds might accrue and two sharing rates which are summarized in Table V in the Appendix. That is, a retailer with a 3.8% accrual rate and a 1:1 sharing formula would be able to spend up to 7.6% of its total purchases from Magnavox on approved advertising and pay only half; the other half would be paid by Magnavox out of the funds set aside in the cooperative advertising account.

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91. File 8822-4-14-3, CX 143.

92. File 8822-4-3-2, p. 17.

93. File 8822-4-1, p. 30.

94. The program is described in the last ten pages of File 8822-4-14-2 and File 8822-4-3-2, pp. 87-89.

The first three accrual rates were available to retailers depending on their volume of Magnavox sales, with large retailers having higher rates. The four percent rate was available only to HECs. Most dealers received the 1:1 sharing rate, but HECs and large dealers received the 2:1 rate. In addition, purchasers of carload and truckload lots received an option between a cash discount and a further increment to the cooperative advertising account.

The dealer was not free to spend funds accruing in the account in any manner he saw fit. All advertising paid for from the account had to be approved by Magnavox.<sup>95</sup> Specifically prohibited was the advertising of any prices other than the Magnavox-approved price. In its listing of "Co-op Advertising Don'ts" distributed to its dealers, Magnavox warned:

*Do not* advertise reduced prices. (Except in Once-a-year clearance sales as authorized by the factory.) Inferred sales of any kind or "was-is" or "now only" price comparisons, are not permitted. Trade-ins or special allowances *must not* be advertised unless it conforms to *current* Magnavox Sales Policy.<sup>96</sup>

Only advertising in Audit Bureau Circulation newspapers was approved. The fund could also be used to pay for signs, posters, and Magnavox literature (all of which Magnavox sold to the dealers). All "secondary media" had to be recommended by the regional manager and approved by the factory in writing. A number of media specifically were not approved for the program—classified

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95. This was not always the case. The February 1962 letter from Freimann to dealers noted that relaxation of the policy in the previous years had not worked well and that, therefore, Magnavox was returning to a centralized advertising strategy:

Many of these effective rules of the Magnavox advertising philosophy have been watered down in recent years in an appeasement effort to "please everyone." We are far too preoccupied with the problems involved in selling the Magnavox products through you in volume to engage in problems of unpleasant advertising disputes. Unfortunately this has been a deterrent in too many cases in producing effective advertising at the retail level.

In view of the evidence of the last few years at hand, we are returning to our policy of qualifying advertising only on company prepared advertising mats

....

*Therefore, your advertising will not be eligible on a cooperative cost basis unless our factory prepared advertising material is used.*

File 8822-4-14-3, CX 114.

96. *Id.* CX 141.

newspaper ads, telephone directory display ads, and Christmas catalogues.

Thus, one function of the cooperative advertising account was to facilitate enforcement of the RPM policy. To claim their share of the funds, dealers had to submit all newspaper advertising to Magnavox and include in that advertising the Magnavox suggested prices. Policing of price advertising was greatly simplified. But disentangling the motives inherent in the reward structure is a bit more difficult. Surely, one aspect of these motives is the intent to lower the relative price of newspaper advertising to offset the disincentives caused by free riding and to tilt the retailer service mix in this direction.

The higher matching rate and the accrual rate of the HEC is partially explained by the fact that HECs are located in more populated areas where there are apt to be more competing Magnavox dealers benefiting from the advertising.<sup>97</sup> This inference is strengthened by the fact that the prevailing sharing rate in the industry was 3:1.<sup>98</sup> The less selective distribution policies of other manufacturers made it more difficult for local dealers to appropriate the gains from local newspaper advertising and necessitated higher sharing rates to dampen their incentive to free ride. The reward structure also quite probably provided payments to (or discounts for) dealers for the additional service offered by HECs, and discounts to larger customers (both in the accrual rate and the carload/truckload discounts). These discounts are probably a manifestation of attempted evasion of Robinson-Patman restrictions.

The FTC staff painted a rather confused picture of the nature and intent of the cooperative advertising program in an internal memo:

Although its dealers receive the profits of a full markup on all Magnavox products they sell, . . . [Magnavox] has not been lacking in imagination as to how it can intercept such dealer gross profits before they become net profits and use them for its own purposes. In pursuit of that objective, . . . [Magnavox] has been successful in siphoning off substantial amounts to finance its cooperative advertising and promotional programs. On the

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97. See Appendix, Table III.

98. File 8822-4-14-3, p. 87.

basis of industry sales, Magnavox and its dealers engage in the costliest advertising and promotion in the market. These cooperative programs are designed to have their maximum impact in the dealer's local trading area and serve to focus consumer attention on the individual Magnavox dealer.<sup>99</sup>

While the staff quite correctly noted that a cooperative advertising program will encourage local advertising effort, it implied that Magnavox gained at the expense of the dealers. Surely, there is no reason to believe this to be true. To speak of Magnavox "intercepting" gross profits misses the essential element. By structuring the incentives for its dealers, Magnavox could induce them to alter the mix of retailing services they provide.

## 2. *Volume Incentive Plan*

Magnavox first introduced an incentive rebate program in June 1958. On May 1, 1959, it discontinued the program effective June 30, 1959. President Freimann stated: "The program has not served the purpose for which it was intended and it is too costly for us to bear in relation to the meager 'plus' returns."<sup>100</sup> The program was extremely simple compared to subsequent programs. Dealers could earn a rebate based on their annual purchases from Magnavox. For annual purchases exceeding \$200,000 the rebate (on the portion in excess of \$200,000) was two percent—the highest attainable rate.<sup>101</sup>

A new incentive rebate system was introduced in the following year.<sup>102</sup> Thereafter, Magnavox revised the terms of the agreement on an ongoing basis. The central features of the Volume Incentive Program (VIP) were: (a) conditions the dealer must meet to qualify for the program, the most important relating to the breadth of the Magnavox product line carried by the Magnavox dealer; (b) quotas for particular categories and a total quota; and (c) awards for meeting the quotas.

With minor rewording, changes in the VIP agreements of 1964-

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99. FTC staff recommendation, December 1969, p. 113, File 8822-4-1.

100. File 8822-4-14-3, CX 118.

101. *Id.* CX 150.

102. *Id.* CX 155. A 1962 Magnavox letter notes that the rebate agreement being sent to dealers is the same as the agreement sent in recent years. This suggests that the rebate program extends back to 1960.



1968 all required that a qualifying dealer

[d]isplay and promote Magnavox products on a continuous (twelve months) basis in every product line. B/W Television and color consoles and stereo theaters incorporating all tube sizes offered by the company, Stereo high fidelity, both consoles and portables, as well as Magnavox radios and tape recorders, providing the dealer traffics in such products.<sup>103</sup>

In addition the dealer had to "[m]aintain a complete display of Magnavox products which will be representative of all product categories. The products on display must include those models which the company will prescribe twice during the year and new models which may be specified from time to time."<sup>104</sup> The 1964 and 1965 agreements specifically required that the dealer carry at least seventy-five percent of the models in each product category.<sup>105</sup> All HECs, of course, automatically qualified for the VIP.

A 1964 letter to dealers from Freimann emphasized the importance of these conditions:

It should clearly be understood that unless these models that we consider so essential to the attainment of the maximum amount of business and giving us the minimum amount of representation we need, are in your store or at least on order by June 6, you will not only forfeit your participation in the first six months [of the] . . . program but you will also be disqualified for the balance of the year.<sup>106</sup>

The conditions did alter the dealer's incentives. One dealer noted that to qualify for the incentive bonus it had to display eight to ten models that it would not otherwise carry.<sup>107</sup>

The quota systems were somewhat complex. Annual quotas of purchases from Magnavox<sup>108</sup> were established and then broken

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103. *Id.* CX 101 is a copy of the 1967 Volume Incentive Agreement.

104. *Id.* CX 101.

105. File 8822-5-1-4, pp. 124, 331.

106. File 8822-3-4-1, p. 119. If the dealer achieved the total quota but failed to achieve all the minimums, he would still receive a bonus. The bonus would be two percent of adjusted total purchases—total purchases less \$20,000 (as before), less the quota for the category in which the minimum was not achieved.

107. File 8822-4-3-5, p. 483.

108. Note that quotas are based on wholesale price, not retail.

down into two half-year quotas with sixty to sixty-five percent of the amount to be attained in the second half.<sup>109</sup> The agreements established quotas for particular categories and for total purchases from Magnavox.<sup>110</sup> Because these years mark the takeoff of the color television industry, it is not surprising to see the subquotas and categories changing dramatically.

If the dealer met *all* subquotas *and* the *total* quota in the six month period, then he would receive the bonus award. (In 1967 and 1968 it was possible to meet the three subquotas and still fall short of the quotas.) If the quota were met, but the dealer fell short in at least one of the product lines, the award would be based only on sales in the product groups in which the subquota was exceeded.<sup>111</sup> If all quotas were met in both halves of the year, there would be an additional award of ten percent of the bonus.

If the quotas were met, the dealer was rewarded according to a bonus schedule. As shown in Table VII in the Appendix, the schedules differed somewhat from year to year. Since the dealers generally were not informed of the terms of the agreement until May, it is unlikely that the precise terms of the schedule were of great importance in altering the dealer's incentives. In 1964-1966 the awards were based on total volume.

In 1967 Magnavox shifted its approach, basing the bonus on the dealer's performance relative to his quota.<sup>112</sup> If the dealer met the quota precisely it would receive a two percent bonus on all its purchases in excess of \$20,000. The bonus rate (an average—not marginal rate) was a nonlinear function of the ratio of the actual purchases to the dealer's quota. The bonus rate rose steeply as the actual sales approached the quota from below, and the rate rose slowly if the quota of twenty-five percent growth were exceeded. Thus, if the growth rate were only ten percent, the bonus would be 0.21%; if the growth rate were twenty percent the bonus would be 0.88%; a twenty-three percent growth rate would give a 1.55% bonus. If, however, the growth rate were thirty-five percent, substan-

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109. See Appendix, Table VI, row 1.

110. See Appendix, Table VI.

111. The 1956 agreement did not provide for payment if the dealer failed to meet any of the subquotas. Magnavox amended this in a letter to dealers in November that year. File 8822-4-5-2, p. 773.

112. The terms remained the same in 1968. File 8822-4-14-3, CX 106.

tially exceeding the quota, the bonus would be only 2.132%; the maximum bonus was 2.25%.

The record provides neither an indication of what percentage of Magnavox dealers participated in the VIP nor a calculation of the success rate of those dealers who did. The FTC investigator argued that the VIP granted discounts that were arbitrary and discriminated against small dealers who could not qualify because they could not profitably carry the items Magnavox required. By excluding certain dealers, Magnavox could provide discounts to selected retailers and circumvent the Robinson-Patman Act.<sup>113</sup> It is clear that the program was more attractive to larger dealers who could carry a more complete line and who would receive a discount which increased with volume.<sup>114</sup> But without knowledge as to the usage of the program and the success rate of the users, it seems idle to speculate on this.

The picture that emerges is that of a program in flux. Magnavox was groping to find some scheme with which it could reward multiline dealers for increasing their Magnavox emphasis. Given that Magnavox appears to have been so interested in devising a workable incentive scheme, it seems reasonable to ask why. Although a firm answer cannot be given, three reasons appear plausible.

First, since the markups vary over the product line, it is possible for dealers to concentrate their efforts on those items which have a high markup, given their "salability."<sup>115</sup> Since markups are determined on a national basis, in some geographic markets a given markup will permit a dealer to sell much more of a particular model than in other markets (and much less of other products). Rewarding dealers for carrying a larger line and meeting separate subquotas is one way of reducing the incidence of this "cream skimming." A 1966 letter to dealers sent with that year's VIP agreements stated:

Your Magnavox Franchise . . . stipulates that you are to give us

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113. File 8822-4-3-17, p. 2307.

114. Through 1966 the marginal discount increased with total volume. This was not true in 1967, but with the \$20,000 minimum, the average discount rises with volume.

115. A high markup by itself, of course, means nothing. The markup is simply a payment for retail services. The retailer might find a low markup black and white television more profitable in his market than a stereo with twice the markup.

good market sales representation in *every product category*. If you lean on any one area for your sales, you are depriving yourself of greater profit potentials and doing a disservice to your franchise. "Skimming off the cream" has never built a solid foundation to any business, including retailing.<sup>116</sup>

Second, by inducing (or forcing) dealers to buy unwanted models, Magnavox could shift some of its inventory error costs to the dealers. It is not immediately obvious why Magnavox would find this risk-shifting worthwhile. Dealers to whom the risk is shifted will require compensation for bearing the risk. Shifting the cost would be a rational policy only if: (a) dealers are less risk averse than Magnavox (which is most unlikely); (b) dealers are in a better position to control the magnitude of the loss by directing their retailing effort toward more aggressively pushing the slow movers; or (c) confronting dealers with an all-or-nothing choice enables Magnavox to capture some of the economic rents associated with being a Magnavox dealer.

Third, the larger Magnavox's share of a particular retailer's sales, the more intensive would be the retailer's Magnavox selling effort. If the customer finds a particular model not in his budget range, the salesman might try to persuade that customer to buy a somewhat cheaper Magnavox. If, however, the retailer carries only a few Magnavox models, the salesman is more likely to push a non-Magnavox set instead. Therefore, one of the virtues of putting out a product line is lost to Magnavox.<sup>117</sup> Also, if selling Magnavox at retail is enhanced by acquainting salesmen with Magnavox literature and by providing salesmen with special training sessions, the retailer is more likely to find it worthwhile to incur these costs if Magnavox accounts for a larger part of his line, *ceteris paribus*. The unit costs of intensive retailing depend on the individual pro-

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116. File 8822-4-5-2, p. 514. It is conceivable that Magnavox was offering the bundle to facilitate price discrimination against its dealers. It can be shown that offering an optional package along with the individual items can have the same results as full-line forcing or block booking (or other forms of tie-ins). See Adams & Yellen, *Commodity Bundling and the Burden of Monopoly*, 90 Q.J. ECON. 475-98 (1976).

117. A variant of this point would have the dealer advertise Magnavox products to lure customers into the store and then sell them other products. Worse (from the Magnavox point of view), it might use the Magnavox equipment to make invidious comparisons. The larger the share of its sales in Magnavox products, the less likely such comparisons will be.

ducer's share of a particular retailer's sales in that (and related) product line(s).

### 3. *Model Change*

For consumer durables subject to change in both style and technology, manufacturers have to determine the rate at which new products are introduced and old products are phased out. They must also determine how best to implement those strategies. The difficulties are exacerbated if the manufacturer sells products to dealers who make their purchases in reliance on their expectations concerning the future policies. The losses due to obsolescence are, like losses arising from shoplifting and vandalism, covered as part of normal, expected overhead costs. High volume dealers in other brands could move discontinued models by cutting prices or reselling to specialist dealers who handle discontinued models. For Magnavox dealers, the problem was somewhat more difficult. Their margins were higher, and therefore if an existing product in their inventory was rendered obsolete their reliance loss was greater. Moreover, their ability to move the item was constrained by the RPM policy and restrictions on transshipment.

The franchise agreement included a clause stating Magnavox's intention of limiting model turnover: "[Magnavox's] policy . . . is designed to protect the Dealer's inventory investment by making model and style changes only for the purpose of maintaining the technological progress required to keep our products out in front of competition."<sup>118</sup> In its exhortations to dealers Magnavox stressed this aspect of its policy:

[Magnavox has] no planned obsolescence—the kind of obsolescence that obsolesces the dealer's inventory although ostensibly designed to make the customer dissatisfied with what he has just bought.<sup>119</sup>

Because Magnavox does not introduce "annual lines" for the purpose of planned obsolescence, both you and your customers are protected from semi-annual or annual "industry" cabinet styling or "fashion" changes. Gone is the need for frequent

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118. File 8822-4-14-3, CX 117.

119. *Id.* CX 135.

profit "dumps" in order to make way for an annual or semi-annual parade of "new" models. Magnavox incorporates changes into its instruments for the purpose of improvements, visible and demonstrable step-ups as well as plus benefit features . . . not for the purpose of obsoleting your inventory.<sup>120</sup>

When models were discontinued, some policy was necessary to enable dealers to mitigate their losses. In response to sporadic price cutting on discontinued models, Magnavox adopted a specific procedure in 1959. Failure to comply was considered a breach of the franchise agreement. The policy was straightforward:

Thirty days after a model has been dropped from a current Magnavox price list that model may be reduced to a maximum of 10% to clear the decks for new models and to help dealers properly adjust their inventory. Six months after a model has been dropped from a current price schedule, it may be reduced to a maximum of 15%. After eleven months, any model becomes open-ended and may be reduced to whatever makes sense to move that model.<sup>121</sup>

#### 4. *Price Guarantee Policy*

Magnavox dealers were not agents; they were independent businessmen who bought Magnavox products and then resold them. If the price of the equipment changed after the dealer bought it from Magnavox, the gains or losses would remain with the dealers. Nonetheless, Magnavox provided some protection for dealers from price reductions with its Price Guarantee Policy.<sup>122</sup> (Magnavox continued to bear the risk of price increases.) Magnavox claimed that as of 1959 it was the only company in the industry to have such a policy.<sup>123</sup> The policy declared that in the event of a price

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120. *Id.* CX 150.

121. *Id.* CX 151. For discontinued merchandise still owned by Magnavox, the policy was to lower the price to the dealer and to enforce the new resale prices as if they were regular models. A 1962 internal memo noted: "You will note that we have priced the merchandise in accordance with the length of time that it has been obsolete, feeling that probably the cream has been skimmed off of the models which have been discontinued longer, and accordingly extra price concessions are given." *Id.* CX 139. The memo went on to note that the models should be "sold as any other merchandise at these prices." *Id.*

122. File 8822-4-5-1, p. 423.

123. File 8822-4-3, CX 135.

reduction, dealers would be credited with the difference between the price paid by the dealer and the newly established dealer's price (at the same quantity discount bracket as the initial transaction). The guarantee held for ninety days following shipment on products other than televisions and forty-five days for televisions. The guarantee applied to all units for each model in excess of one. The guarantee did not apply to instruments for which price was reduced for the Factory Authorized Annual Sale, nor for models that had been eliminated from current price lists (discontinued models).<sup>124</sup>

The guarantee reduced the risks to dealers of carrying a large Magnavox inventory. It also tended to tilt the rewards more toward large volume dealers with a rapid turnover of products because their share of unprotected instruments was likely to be smaller.

#### D. *Summary*

Magnavox specialized in producing retail service-intensive products (e.g., televisions-as-furniture units). There is some evidence that Magnavox provided more post-sales service than did manufacturers not using a selective distribution system. Probably more important, however, was the pre-sale selling effort consisting of display and personal selling. Price maintenance provided a fixed retail margin to pay for these retailer services. It also provided protection from other retailers who might attempt to free ride on this selling effort by offering the same product at a lower price. Magnavox's cooperative advertising program enabled it to police retailers' advertising of price cutting. Also, it reduced the effective cost to the retailer of local advertising; the reductions appeared to be greater for retailers who were more likely to have difficulties appropriating the benefits from their advertising effort (those in large urban markets who would meet competition from other Magnavox dealers).

Magnavox established sales quotas for dealers who chose to participate in the Volume Incentive Program. Rebates were based not on the total volume of sales, but on the percentage increase from

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124. File 8822-4-5-1, p. 423.

the previous year. Separate quotas were established for different product lines, and participating retailers were required to carry specific models. Although the terms of the program changed frequently, the basic emphasis appeared to focus on encouraging retailers to carry a broad line of Magnavox products.

In addition, obsolescence typically raises problems for firms utilizing a resale price maintenance system. Magnavox's strategy for coping with this problem appears to have had two elements. First, it made fewer style changes than did its competitors so that its models would have longer lives. Second, it established a schedule for reducing prices over time for models that had been discontinued.

With RPM, retailers have an incentive to shade their prices. To discourage hidden price cuts, Magnavox did not permit its dealers to give either trading stamps, free records, or allowances on trade-ins exceeding the established trade-in schedule. Magnavox also sought evidence on price-cutting and penalized dealers who engaged in it. Magnavox's enforcement is described in the next section.

## V. MAGNAVOX'S ENFORCEMENT OF RPM

Magnavox's enforcement efforts were not subtle.<sup>125</sup> It encouraged dealer reporting of price cutting and hired private investigators to shop at some of its dealers. If dealers were caught shading prices they were sometimes terminated, but usually this came to pass only after Magnavox could not get assurance that the price cutting would not be repeated. Evidence on policing was not collected systematically by the FTC investigators. Indeed, the bulk of the information on enforcement was from FBI interviews in the summer of 1962 relating to an Antitrust Division investigation of Magnavox.<sup>126</sup> There is enough information, however, to provide at least anecdotal evidence on the nature of enforcement and to suggest the extent of the dealer's vulnerability to Magnavox's coercion and threats.

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125. For an example of a gentler policy, see Goldberg, *supra* note 10, at 249-54.

126. File 8822-4-15.



### A. *Policing—Detection*

A Magnavox dealer reported to the investigator that "the real policing with respect to the Magnavox price adherence program is not by the Magnavox company, but is through the Magnavox dealers themselves who, in effect, police each other and report price violators to the Magnavox salesman."<sup>127</sup> In a typical scenario, a retailer would learn from a customer that another dealer was offering merchandise at a lower price (or with a hidden discount) and would then either report the incident to Magnavox or shop the alleged offender to gather evidence (*e.g.*, an invoice).<sup>128</sup> While complaints to the local Magnavox sales representative were often sufficient to bring action, in some instances the complainers went over the sales representative's head.

The sales representatives also gathered information on their frequent visits to the dealers. Representatives typically checked price tags on displayed items<sup>129</sup> and sometimes inspected invoices or other documents revealing transaction prices.<sup>130</sup> One interviewed dealer signed a statement to the effect that the Magnavox salesman "has access to [its] inventory control card system to keep track of what products are sold and in so doing is aware of the prices at which Magnavox items are sold to consumers."<sup>131</sup>

Magnavox also hired private investigators to shop its dealers on occasion. The record includes one instance of Magnavox buying such services from Merit Protection Service, Inc., which advertised itself as "One of America's Leading Shopping Services."<sup>132</sup> Merit's acceptance letter indicates the nature of the service:

In compliance with your authorization, we shall shop the

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127. File 8822-4-3-12, p. 1400. For similar statements, see File 8822-4-3-10, p. 1322; File 8822-4-3-13, p. 1527; and File 8822-4-3-13, p. 1457.

128. File 8822-4-3-10, p. 1322; File 8822-4-3-14, p. 1723; and File 8822-4-14-3, CX 123, 138, 145, 156, 157, 158, 163. CX 161 provides an example of an individual dealer hiring a private investigator.

129. File 8822-4-3-7, p. 945; File 8822-4-3-10, p. 1236; File 8822-4-3-10, p. 1293.

130. Checking of invoices appears not to have been standard policy. One dealer stated that he had never had his invoices checked. File 8822-4-3-10, p. 1293. A second noted that Magnavox had started checking his invoices about a year before the interview but stopped when the dealer protested. *Id.* at 1307.

131. File 8822-4-3-7, p. 1006.

132. File 8822-4-14-3, CX 169.

eleven units indicated, three times each to determine the courtesy and efficiency of the employees and whether the price structure is being maintained.

We usually check on one particular brand or style number which you might be interested in, but . . . [your aide] informed me that any style would suffice, as long as the dealers are holding the price line.

Our charge for these eleven stores, checked three times each will be \$495.00, based on our previous rate of \$15.00 per survey.<sup>133</sup>

To detect transshipping to unauthorized dealers Magnavox would have a shopper place an order with a dealer for an unusual model and the factory would be alerted. The authorized dealer placing the order then would be identified as the culprit. The serial number of the set would not always provide sufficient information since bootleg sets often had the serial numbers removed. The record provides one example of a detective's investigation of a transshipping incident in which the serial number had been removed; he brought the police to the store to inform the dealer that selling equipment with the serial number removed was a violation of the California Penal Code.<sup>134</sup>

### B. *Policing—Discipline*

Magnavox promised dire consequences for price cutters. In a 1961 advertisement to the trade it stated that price cutting does not occur "because that firm uncompromising unrelenting firehorse, Frank Freimann, will not let it develop, stamps it and you out the first time you try any fancy footwork."<sup>135</sup> A number of dealers, however, noted that Magnavox's policy was not to terminate a dealer immediately for cutting prices or for transshipment.

If a dealer acquired a notorious reputation for price cutting or for dropping Magnavox resale prices, he could lose the Magnavox franchise. If a sporadic price cutting incident has occurred Magnavox will let the dealer concerned know that Magnavox knows about the price cutting activities. It will not

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133. *Id.*

134. *Id.* CX 115.

135. *Id.* CX 161.

cut off the dealer or take away the franchise unless the particular dealer's price cutting activities have become notorious.<sup>136</sup>

Some dealers reported that the Magnavox salesmen would reprimand or "chew out" dealers deviating from the Magnavox price policies.<sup>137</sup> An internal Magnavox memo describes one such instance:

I have contacted . . . [the dealer] and informed him that he was shopped and is in *real* trouble. I promised to see him next week to discuss it in detail.\* I plan on giving him a *severe* warning. I am sure I can straighten him out.

\*Let him sweat!<sup>138</sup>

In one instance Magnavox required the management and sales employees of a wayward dealer to sign the following agreement:

In order to clarify any future misunderstanding of the Magnavox Company's franchise and policy requirements, verbal or otherwise, the management of . . . [this dealer], and its employees, agree to the following:

1. All Magnavox products will be sold at full retail prices.
2. No conversation can be made concerning free give-aways of records, antennas or otherwise, with their customers at any

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136. File 8822-4-3-14, pp. 727-28.

137. File 8822-4-3-10, p. 1293; File 8822-4-3-7, p. 951.

138. File 8822-4-14-3, CX 171 (footnote in original). I do not mean to give the impression that all (or even most) of the contact with dealers was laced with threats. The following memo gives an indication of the low-key approach:

With regard to the cut price ad mentioned in his letter, it was run by [Dealer X]; this was a direct violation of our franchise.

I discussed this with [X], his explanation was, that since the death of his father 2 months ago, he has been burdened with a great deal of additional work and as a result has placed all advertising and promotions under the control of his ad manager and the various dept. heads.

His advertising manager was advised by the TV Dept. Manager that the 160's were being discontinued, he failed to tell him we are continuing the cordovan finish.

He now understands that under no circumstances is he ever to run a cut price or discontinued ad on Magnavox only when we authorize our clearance sale or promotions. Also [X] has agreed to check all copy of TV ads—they are exclusive MX.

This is the first time we have ever had trouble with [X] and I'm certain it will be the last.

*Id.* CX 128.

time.

3. The Magnavox trade-in policy will be strictly adhered to.
4. The Magnavox advertising policy will be followed to the letter.
5. That . . . [the dealer] and all employees engaged in the selling of Magnavox products read and sign this letter in the designated spaces, realizing that any further violation of said Magnavox policies will be reason for removal as a Magnavox dealer.<sup>139</sup>

If a dealer persisted in his behavior, Magnavox could put pressure on the dealer by "losing" orders, delaying shipments, and generally making the terms of the relationship less attractive.<sup>140</sup> It also on occasion would suspend a dealer, terminating him for a period of one to six months.<sup>141</sup>

The franchise agreement itself was a general document that stated some broad policies governing any future transactions between Magnavox and the dealer. By itself it promised nothing. Dealers realized that—many interviewed dealers could not find a copy of their franchise agreement and could not remember when (or if) they had signed one. Because of this it was not necessary for Magnavox to formally terminate the franchise. It could, and apparently it sometimes did, merely refuse to ship merchandise to a dealer.<sup>142</sup> However, because transshipping to other Magnavox dealers was permitted (to speed delivery and smooth inventory), keeping a dealer in limbo could be costly—he could continue to sell Magnavox by having other dealers wholesale for him.

Miscreant dealers were sometimes subject to direct financial penalties. One former dealer reported to the FBI that he had to pay the difference between wholesale and retail value to the dealer who reported him and who had lost the sale.<sup>143</sup> One dealer gave his impression of the arrangement to an FTC investigator:

° The understanding between Magnavox and its dealers is that if a dealer can procure an invoice from a customer which shows

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139. *Id.* CX 122.

140. Motion for Withdrawal, *supra* note 43, at 1234, File 8822-4-3-10.

141. This was mentioned in a number of the FBI interviews included in File 8822-4-15.

142. Motion for Withdrawal, *supra* note 43, at 2107. This was also mentioned in some of the FBI interviews included in File 8822-4-15.

143. File 8822-4-15.

that a customer had purchased a Magnavox item at a discounted price the dealer concerned could turn in the invoice to Magnavox. Magnavox will give a sum of money equalling the amount of the discount to the customer which was allowed by the discounting dealer and will charge the discounting dealer with twice the amount of the discount shown on the invoice.<sup>144</sup>

### C. Dealer Vulnerability

The franchisor's ability to impose costs upon a dealer provides him with leverage for influencing the dealer's behavior.<sup>145</sup> Cost imposition can take the form of "withdrawing the carrot" or "using the stick" (which blend into each other). That is, one way of influencing the dealer to act in the franchisor's interest is to make continuation in the relationship an attractive proposition. In principle, this might be done by having (a) high annual profits and no damages for breach, or (b) normal profits but high damages. (These do not, obviously, exhaust the set of possibilities.) Thus, even if potential franchisees were homogeneous, it might pay for a manufacturer to offer rewards exceeding the market clearing price. The resultant queue of willing (and by assumption equally capable) dealers provides the manufacturer both the freedom to discipline (the "reserve army of the unemployed" lowers the manufacturer's costs of termination) and the leverage to do so.

The dealer's vulnerability is not immutable, but it is a decision variable that can be influenced by the way in which the parties construct their exchange relationship and the external (*e.g.*, legal) constraints.<sup>146</sup> Thus, in a fair trade state, threats of termination to induce conformance with an RPM system would be backed by the power of the state to enforce the agreement. In a free trade jurisdiction following the *Parke, Davis* rule, gentle reminders or innocent queries could subject the manufacturer to treble damages, whereas overt coercion on other matters would not be penalized by the law. It is also possible that by cleverly structuring their relationship the parties can offset the legal penalty structure with liq-

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144. Motion for Withdrawal, *supra* note 43, at 1758.

145. The dealer can also, of course, have leverage over the franchisor.

146. Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 TEX. L. REV. 91, 117-29 (1979); Goldberg, *Relational Exchange*, 23 AM. BEHAVIORAL SCIENTIST 337, 348-51 (1980).

uidated damage clauses or other more complex devices.

The higher the reward to the dealer, the greater is the temptation to the manufacturer (and its salesmen)<sup>147</sup> to attempt to share these rewards. That is, they have incentives to feel out the dealers to learn whether some of their profits can be captured by various devices. (This is akin to feeling out consumers to determine their willingness to pay a higher price—it is “price discrimination” using nonprice tools.) There is an apparent contradiction here. The manufacturer provides high rewards to keep the dealer in the relationship, but then attempts to undo this effort by recapturing the profits. Such behavior is explainable, at least in part, by noting that it is difficult (and costly) for the manufacturer to devise the relationship to eliminate opportunistic behavior on its part—especially on the part of its salesmen. As the reward rises so too does the cost of controlling the opportunism.

One device that appeared to be commonly used by Magnavox was to induce the retailer to carry a larger line than he otherwise would with the threat of termination or less cooperation (longer lags) as the stick. (The VIP was the carrot.) The FTC investigator’s report on his interview with one dealer, a member of the Marta buyer’s cooperative, is indicative of the Magnavox technique; it also shows that dealers were capable of resisting:

Pressure has definitely been placed on [him] to carry a full line of merchandise, i.e., to buy certain models of Magnavox’s products which he ordinarily would not. Otherwise, they would take away the franchise from [him]. This type of pressure became very acute, especially since [he] rebuffed such efforts by Magnavox.

When Magnavox wanted to take away his Washington, D.C. franchise, Marta rebuffed this effort and indicated that all of its members in the Washington, D.C. area would drop the Magnavox line if such pressure . . . was not released.<sup>148</sup>

The FBI interviews uncovered a number of discontinued dealers

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147. It is important to realize that, just as the interests of the manufacturing firm and the franchisee are not always identical, the same is true of the firm and its salesmen. If, for example, Magnavox salesmen receive some of their compensation on a commission basis, they will sometimes find it in their interest to sell an extra unit to a retailer even though that sale is unprofitable for the firm.

148. File 8822-4-3-9, p. 1211.

who complained about Magnavox's attempts to force merchandise on them. One Philadelphia dealer reported that:

[H]e had been discontinued as a Magnavox dealer when he had refused to sign an order form which had been prepared by Magnavox and submitted to him by [the Magnavox salesman]. He said that it was always the practice of Magnavox to dictate to the retailer the quantity and type of merchandise they were to sell.

. . . .

At that time . . . the representative from Magnavox had told him "We know how to take care of dealers like you." . . . [H]e never received any notice from Magnavox stating that he had been discontinued, but he had been stuck with 30 of the Magnavox sets at that time and was unable to trade them or obtain popular makes.<sup>149</sup>

The dealer suggested that one reason for his termination was that Magnavox was not interested in doing business with a small dealer like him. If the producer is willing or even eager to terminate a dealer, then it makes sense for him to try to capture the economic rents inherent in the franchise in the pretermination stage. (That statement must be qualified to take into account the possible "negative goodwill" that such behavior might produce; relationships with other dealers would be more expensive to maintain.) Opportunistic behavior is most likely to arise when the discipline of future dealings between the parties does not constrain one of them.

A small Chicago ex-dealer described some of his difficulties:

His disenfranchisement came about because of Magnavox's policies. Magnavox persistently urged that he keep a good representative stock of Magnavox merchandise on his floor display as well as inventory stock. His operation was not large enough to warrant an investment as large as Magnavox desired. It was also the practice at Magnavox to continually send him new models four to six times a year, regardless of whether or not he wanted them. He refused to accept some of these shipments and had them returned to the factory. He knows that many other Magnavox dealers have also complained of this latter practice of

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149. File 8822-4-15.

Magnavox. Also the Magnavox Company would, from time to time, send him advertising literature for which he was partially charged. There were many service problems with the Magnavox products which were not encountered with other brands.

Last year he was called in to the Magnavox regional office and urged to sell more merchandise. He was told what merchandise he should have on his floor and the suggested inventory he should have to back it up. He delayed in ever agreeing to this set-up and it was never affected. Subsequently, the Magnavox salesman told him that he would have to stock up or cease to be a dealer.<sup>150</sup>

Another small Chicago ex-dealer (who dropped his franchise with Magnavox following a dispute on a different matter) noted that about once or twice every six months Magnavox would send him merchandise that he did not order.<sup>151</sup>

If a dealer were terminated, he would lose sales during the period in which he replaced the Magnavox line. One terminated dealer told the FBI that it took him about six months to build up the other lines because he had become so identified with Magnavox.<sup>152</sup> For most dealers (other than HECs), this loss of brand-specific goodwill was not a major concern, however, because they already carried a substantial non-Magnavox line.

The termination threat might have been credible in 1964-1966 when television sales were accelerating. Many producers were rationing their output with allocations usually related to past purchases. Consequently, a terminated dealer might have found it difficult to replace his Magnavox line at that time. While that circumstance undoubtedly improved Magnavox's bargaining power vis-a-vis its dealers, there was little call for Magnavox to use that power in enforcing resale price maintenance at that time. Given the shortages, price shading would have been an unattractive strategy for dealers.

The disposition of goods in the dealer's possession when a franchise is terminated creates a problem. Fair trade states generally provided that the dealer could resell at a price below the

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150. *Id.*

151. *Id.*

152. *Id.*



agreed upon price. He first, however, must offer his stock to the manufacturer at the original invoice price at least ten days before offering it to the public.<sup>153</sup> The producer can take advantage of the dealer's holding of inventory in two ways. First, the possibility that the dealer will suffer financially from holding the remnants of a closed-out line makes exit a less attractive option to dealers. Second, when a dealer is terminated the producer can behave opportunistically. The dealer, however, is not helpless in such situations. A brief description of the outcomes in some of Magnavox's terminations will flesh out the picture.

An Augusta, Georgia dealer told the FBI that he had an oral agreement with Magnavox that if competitors sold below the suggested retail prices "Magnavox would cut off supplies to those retail outlets and, if necessary, purchase the remaining Magnavox items in their possession."<sup>154</sup> That dealer gave Magnavox evidence of a competitor's price cutting and "soon thereafter Magnavox purchased all of [the competitor's] remaining stock of Magnavox items and offered to sell these items to [him]. [He] accepted their offer in order to save the freight costs."<sup>155</sup>

Two small terminated Chicago dealers were not able to resell their merchandise to Magnavox; each was told that the small stock they had on hand was not enough to hurt Magnavox.<sup>156</sup> A third noted that Magnavox did not pick up his stock until he threatened to advertise his Magnavox stock at cut prices.<sup>157</sup>

A larger dealer, terminated for transshipping, reported on a more complex set of post-termination negotiations:

At the time Magnavox picked up the merchandise from his store, they took it to a warehouse and sold it to various other dealers. They then gave [him] credit for what they received from the other dealers. In some instances there was a considerable discount and he did not feel this was in accordance with the terms of the franchise agreement, which stated that if the franchise were cancelled and the merchandise picked up, Magnavox would reimburse the dealer at the invoice prices. He

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153. *E.g.*, ILL. ANN. STAT. ch. 121½, §§ 188-191 (Smith-Hurd 1960) (repealed 1977).

154. File 8822-4-15.

155. *Id.*

156. *Id.*

157. *Id.*

demanding that either he be paid the full invoice price for the merchandise picked up or that the merchandise be returned. Finally, after he had threatened suit . . . Magnavox issued a credit of \$1,450.90, which was the difference between the amount they had previously paid him and the invoice prices.<sup>158</sup>

A terminated dealer was not without recourse. He also could make life difficult for Magnavox by holding the Magnavox inventory and using it to make invidious comparisons in selling other brands.<sup>159</sup> The following exchange between a Magnavox salesman and his superior nicely illustrates this point:

They have five models of Magnavox on the floor that have been obsolete for about a year. We haven't been able to prove to our own satisfaction that they are "kicking" these in order to sell competitive merchandise, but that is a reasonable assumption . . . . The General Manager of the store . . . refuses to sell them to us. He has them priced at around 12% above cost.

As yet, this is not a major embarrassment to us in this market. We have told the two local dealers of the situation and they are sympathetic.

Have you any suggestions? Are there any legal steps that . . . [we might take]?<sup>160</sup>

. . . .  
May I suggest you make arrangements for the dealers to purchase the instruments at the subject store and then we refund them the difference between what they pay for them and what we sell them for.

This may work out better than any legal action. Suggest you try!<sup>161</sup>

The FTC investigator reported on an interview with a former Magnavox dealer: "Magnavox products are still kept on hand because . . . they are criticized and knocked by [the owner] when [he] is making a sale of a competitive item to a customer."<sup>162</sup>

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158. *Id.*

159. This could be a profitable strategy for the dealer; however, he also might deliberately accept the losses that arise from the strategy in pursuit of revenge.

160. File 8822-4-14-3, CX 130.

161. *Id.*

162. File 8822-4-3-4, p. 360.

## VI. CONCLUSION

The Magnavox investigation was a diffuse, unfocused affair with much of the investigative effort directed at Robinson-Patman matters which proved to be a dead end. In part because of the lack of focus, the files provided a considerable amount of information. By contrast, an FTC investigation of Lenox focused on the narrow issue of whether Lenox's enforcement of retail prices went beyond the *Colgate-Parke, Davis* boundaries.<sup>163</sup> Although the sharp focus yielded a much more manageable case, the investigation provided a sketchier picture of the marketing arrangements. To be sure, large gaps remain in our understanding of Magnavox's system. For example, how many dealers took advantage of the VIP programs? How did Magnavox's implementation of its program in large urban areas differ from what occurred in the numerous small markets in which only one retailer carried Magnavox? How did Magnavox's behavior (and results) change when other firms—notably Sony—utilized a selective distribution strategy? Still, by relying almost exclusively on the materials in the FTC files, we have been able to provide a reasonable first approximation of Magnavox's marketing system and the role of vertical restrictions within that system.

Before turning to the merits of the prosecution, it is instructive to reflect upon Magnavox's compliance with the existing law. The *Parke, Davis* decision appeared to have restricted drastically the ability of firms to enforce price maintenance. One court interpreted *Parke, Davis* thusly: "The Supreme Court has left a narrow channel through which a manufacturer may pass even though the facts would have to be of such Doric simplicity as to be somewhat rare in this day of complex business enterprise."<sup>164</sup> A pamphlet published after *Parke, Davis* advising firms on the boundaries of permissible action stated:

What you can do: (1) You may announce your policies, including suggested prices at which your goods are to be resold or minimums below which no reseller may quote. (2) You may

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163. See Goldberg, *supra* note 10.

164. *George W. Warner & Co. v. Black & Decker Mfg. Co.*, 277 F.2d 787, 790 (2d Cir. 1960).

withdraw the line from anyone who does not follow your suggested prices.

What you can NOT do: (1) You may not get your customer to agree, no matter how informally, that he will observe your suggested resale prices. (2) You may not get the help of others in enforcing your prices. For instance, you cannot use wholesalers to police dealers handling your line, or get retailers to report price cutting by stores in their area. In a word, your actions must be completely independent.<sup>165</sup>

Some firms (for example, Lenox<sup>166</sup>) did attempt to fit into the "narrow channel." Magnavox, it is clear, did not. Published promises that "firm uncompromising unrelenting firehorse[s] . . . [will stamp] it and you out the first time you try any fancy foot-work"<sup>167</sup> are not designed to remain in the narrow channel. Nor are they designed to escape detection. It is, in retrospect, remarkable that a well-publicized decision should have had so little effect on a large firm with access to top legal talent. It also is sobering to observe that behavior deviating so far from that narrow channel with no attempt at concealment would remain undiscovered for so long by the enforcement agency.

Given the state of the law in 1970, it was perfectly reasonable for the Commission to file a complaint against Magnavox and to conduct the investigation without considering possible justifications for price maintenance. In the post-*Sylvania* context, however, the question, as Justice White suggested, ought to be raised. And the answer seems clear: there was almost certainly no public purpose served by interfering with Magnavox's marketing strategy. Selective distribution with RPM was clearly a minority strategy in the television industry. Magnavox was aiming at a market segment that was less accessible by conventional marketing methods. RPM could not have been an element in a manufacturer's cartel, nor could it have been used to facilitate dealer collusion. The only collusion argument that is feasible is to identify the particular market segment as the relevant market and argue that Magnavox's large market share facilitated collusion in that market. That is a thin

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165. Cited in Goldberg, *supra* note 10, at 251.

166. *See id.* at 249-51.

167. *See* note 135 & accompanying text *supra*.

reed, indeed.

A single case study cannot, of course, prove that on balance a *per se* rule against price maintenance is undesirable. However, it does provide considerable support for Justice White's suggestion that the distinction between price and nonprice restrictions is artificial. There is little reason to believe (and good reason to doubt) that the law regarding restrictions on price should differ in many (if any) respects from the law regarding nonprice restrictions.

The state of the law regarding nonprice restrictions is still unsettled in the wake of *Sylvania*. Some of the commentary<sup>168</sup> and recent decisions have given a very narrow reading to *Sylvania*. In *In re Coca Cola Co.*,<sup>169</sup> *Beltone Electronics Corp. v. FTC*,<sup>170</sup> and *Eiberger v. Sony Corp. of America*,<sup>171</sup> for example, these practices were found in violation on the basis of a rule of reason standard, although one would be hard-pressed to identify discernible reasons in the opinions. A proper rule of reason would recognize that there are sound business grounds for use of a selective distribution system and the concomitant restrictions on dealers. If the restrictions are not widely used by competing manufacturers or if the industry is not amenable to cartelization (for example, entry at both levels is easy), then the presumption should be that the restrictions are legal. Only if it is plausible that the vertical restrictions could facilitate horizontal coordination should the law be concerned with justifying the restrictions on efficiency grounds.<sup>172</sup> The boundaries of an efficiency defense remain to be determined. Unfortunately, the *Magnavox* record is not helpful in delineating these boundaries because most of Magnavox's competitors did not adopt similar restrictions. While my preference is for a strong presumption in favor of legality, we cannot draw upon this case study to justify this preference.

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168. See Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1 (1978).

169. 91 F.T.C. 517 (1978).

170. 402 F. Supp. 590 (N.D. Ill. 1975).

171. 622 F.2d 1068 (2d Cir. 1980).

172. This is essentially the position taken by R. BORK, *THE ANTITRUST PARADOX* (1978); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PENN. L. REV. 953 (1979).

Manufacturers can enforce vertical restrictions by threatening to impose costs on dealers (for example, threatening termination) who violate the restrictions. The manner in which restrictions have been enforced has raised two very different types of antitrust questions. The first is the *Colgate-Parke, Davis* issue: did the enforcement action take the proper form so that the respondent could successfully avail himself of the *Colgate* refusal to deal defense?<sup>173</sup> As the *Magnavox* story makes clear (and other case studies would surely confirm), the line-drawing between legitimate and illegitimate activities that is required by the *Colgate* exception is an activity that is difficult, irrelevant, and likely to induce those who attempt to comply with the law to engage in costly avoidance behavior. If price maintenance were to be judged by a rule of reason, then the *Colgate* doctrine could simply be discarded. However, if price maintenance remains a *per se* violation, then a sensible economic policy would be to liberalize the *Colgate* defense. That, in effect, would result in a back door rule of reason. Courts could avoid the worst features of the *per se* rule by using a liberalized *Colgate* standard to characterize the activity as beyond the scope of the *per se* rule. That is perhaps inelegant, but it might not be a bad compromise.

The second question concerns the extension to franchisees of extra-contractual protection from the franchisor's exercise of power. Governance of franchisor power is certainly a legitimate concern for public policy, and it is at least plausible that the goal could be pursued via the antitrust laws.<sup>174</sup> In *Magnavox*, the FTC staff put considerable emphasis on the ability of *Magnavox* to impose costs on its dealers.<sup>175</sup> However, the issue of governance is analytically separable from that of vertical restrictions. There is no useful purpose served by requiring the existence of a vertical restriction "trigger" for actions to protect dealers. Thus, even if one believed that *Magnavox* dealers required such protection, the presence or

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173. The same question arises for nonprice restrictions. See, e.g., *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968); *Atlantic Refining Co. v. FTC*, 381 U.S. 357 (1965). If non-price restrictions had been illegal *per se* for as long as price restrictions, this line of cases doubtless would have grown in a parallel manner.

174. See Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 *Tex. L. Rev.* 91, 127-29 (1979).

175. See text accompanying notes 13-16 *supra*.

absence of price maintenance would not matter. The case for protection is undoubtedly stronger the more vulnerable dealers are to the threat of termination and the greater the potential for explosive conflict. Because for most dealers Magnavox products account for only a small portion of total sales and because brand-specific investment is modest (with the possible exception of the HECs), it is unlikely that dealer protection would merit public concern.

**APPENDIX****MAGNAVOX CONSENT ORDER**

Magnavox was ordered to cease and desist from the following:

- A. Establishing, maintaining or enforcing any plan or policy under which contracts, agreements, understandings or arrangements are entered into with dealers in respondent's products (hereinafter referred to in this order as "dealers") which have the purpose or effect of fixing, establishing, maintaining, enforcing or, for a period of two years from the effective date of this order, suggesting the retail prices at which respondent's products (hereinafter referred to in this order as "its products") are to be resold.
- B. Fixing, establishing, controlling, maintaining or, for a period of two years from the effective date of this order, suggesting the retail prices at which its dealers may advertise, promote, offer for sale or sell its products.
- C. Requiring any dealer to enter into verbal agreements or understandings that such dealer will adhere to established or suggested retail prices for its products as a condition to receiving or retaining its dealer franchise.
- D. Refusing to sell its products to any dealer who desires to engage in the retail sale of such products for the reason that such dealer will not enter into its product at respondent's established or suggested retail prices.
- E. Requiring dealers to affix to any of its products on display at their stores price tags bearing its established or suggested retail prices.
- F. Publishing, disseminating or circulating to any dealer any price list, price book or other document designating any mandatory retail price, or, for a period of two years from the effective date of this order any suggested retail price at which its products are to be resold by dealers.
- G. Designating in its own advertising, or in any advertising or promotional aids or materials supplied or sold to dealers, any mandatory retail price, or, for a period of two years from the effective date of this order, any suggested retail price at which its products are to be resold by dealers.
- H. Threatening to withhold or withholding earned cooperative



advertising credits from dealers for the reason that they advertise its products at retail prices other than established or suggested retail prices.

- I. Requiring that a dealer not state a combination price for its products and other merchandise as a condition for reimbursement under any cooperative advertising program pursuant to which reimbursement is offered.
- J. Engaging in any retail sales of its products through its dealers in which it establishes, or, for a period of two years from the effective date of this order, suggests the retail prices or discounts therefrom and at the same time either (i) fixes the time and/or duration of such sale, or (ii) preselects the products to be offered.
- K. Establishing any criteria as to the type of merchandise eligible for or fixing or suggesting the amount of an allowance which dealers may grant on merchandise traded in on the purchase of its products.
- L. Prohibiting dealers from issuing trading stamps to purchasers of its products.
- M. Establishing or enforcing any maximum limitation on their terms or duration of any repair service warranties which a dealer may grant in selling its products, other than warranties offered by respondent, or warranties which a dealer offers in any manner which represents or implies that the warranties are offered by or backed by respondent.
- N. Inspecting sales and business records of any dealer for the purpose of ascertaining the prices at which, or the customers to whom, such dealer sells its products: Provided, however, that nothing in this order shall be deemed to prevent respondent from inspecting such records where such inspection is authorized by law, or is for the purpose of assisting respondent to establish its compliance with the provisions of the order issued on December 23, 1964, in Consent Order No. C-869 [66 F.T.C. 1311], or with any other obligation or requirement of any government authority.
- O. Securing or attempting to secure any promises or assurances from dealers regarding the prices at which such dealers will sell its products.
- P. Requiring, soliciting or encouraging dealers to report the

identity of other dealers, and the prices at which such other dealers advertise, offer for sale or sell its products, or the customers to whom such other dealers sell its products.

- Q. Paying rewards to dealers who provide evidence of discounting by other dealers from the established or suggested retail prices of its products, or who provide evidence of customers to whom such other dealers sell its products.
- R. Levying fines upon dealers who grant discounts from the established or suggested retail prices of its products to purchasers thereof.
- S. Terminating business relationships with any dealer because the dealer has sold or is selling or is suspected of selling its products at other than its established prices or suggested retail prices.
- T. Terminating, harassing, threatening, intimidating, coercing or delaying shipments to any dealer because the dealer has sold or is selling its products at other than its established or suggested retail prices or to any other dealers or distributors of consumer electronic products, or taking any other action to prevent the sale of its products by the dealer to other dealers or distributors of consumer electronic products.
- U. Convening or participating in meetings of dealers for the purpose of obtaining their compliance with any of the acts or practices prohibited by this order.
- V. Securing or attempting to secure agreement to its dealers not to sell its products to disenfranchised or non-franchised dealers.

TABLE I  
Markets with a Single Magnavox Dealer

	I	II	III	TOTAL
Total	396	277	206	879
Single Dealer	113	189	182	484
% Single Dealer	28.5%	68.2%	88.3%	55.1%

SOURCE: File 8822-4-5-1, pp. 367-416

TABLE II  
Number of Magnavox Dealers Advertising in  
Newspapers by Market Size, 1965

Number of Dealers <sup>a</sup>	Market Size <sup>b</sup>		
	I	II	III
1	113	189	182
2	92	64	16
3	60	19	6
4	42	4	1
5	33	1	0
6	19	0	0
7	6	0	0
8	5	0	0
9	7	0	0
10	6	0	0
More than 10	13	0	0

a. In cities with more than one newspaper the largest number of dealers advertising in a single newspaper is given.

b. Markets are cities; cities classified as I are the most populous.

SOURCE: File 8822-4-5-1, pp. 367-416.

TABLE III

**Cities with Seven or More Magnavox Dealers  
Advertising in a Single Newspaper, 1965**

CITY	NUMBER OF DEALERS	POPULATION (1970)	CITY	NUMBER OF DEALERS	POPULATION (1970)
Los Angeles, CA	28	2,816,061	Palo Alto, CA	9	55,966
Philadelphia, PA	19	1,948,609	Redwood City, CA	9	55,685
Buffalo, NY	18	462,768	San Francisco, CA	9	715,674
New York, NY	16	7,894,862	Minneapolis, MN	9	434,400
Baltimore, MD	15	905,759	Albany, NY	9	115,781
Chicago, IL	14	3,366,957	Dayton, OH	9	243,601
Cleveland, OH	13	750,903	Providence, RI	9	179,213
Oakland, CA	12	361,561	Orlando, FL	8	99,006
San Jose, CA	11	445,779	Detroit, MI	8	1,511,482
Miami, FL	11	334,859	Newark, NJ	8	382,417
St. Louis, MO	11	622,236	Cincinnati, OH	8	452,524
Bergen County, NJ	11	898,012	Portland, OR	8	382,619
Nassau County, LI, NY	11	1,428,080	Hayward, CA	7	93,058
San Diego, CA	10	696,769	Denver, CO	7	514,678
Bridgeport, CT	10	156,542	Wilmington, DE	7	80,386
Washington, DC	10	756,510	Grand Rapids, MI	7	197,649
Ft. Lauderdale, FL	10	139,590	Rochester, NY	7	296,233
Louisville, KY	10	361,472	Wilkes-Barre, PA	7	58,856
Milwaukee, WI	10	717,099			

SOURCE: File 8822-4-5-1, pp. 367-416; Census of Population, 1970.

TABLE IV

RATINGS OF VARIOUS MAGNAVOX PRODUCTS BY CONSUMER REPORTS, 1960-70	Stereo-Phono Consoles		Portable Stereo- Phonos		19" B/W TV's		23" B/W TV's		Portable & Table Radios		23" Color TV's		"Small Screened" (11"-13") TV's		CU Survey of Readers: TV Repairs Required 1) 108,000 B/W sets (1966)		2) 90,000 Color TV Owners (1969)	
	1960	11/35a													AFR* <sup>g</sup>			
	1961	11/35			5/19	6/24									WAFR*			
	1962		5/20	6/20	6/20	9/22									WAFR*			
	1963		2/19	6/20											WAFR*			
	1964		2/17			13/15	12/24								WAFR*			
	1965	6/16		5/14		15/19									SWAFR*	WAFR*		
	1966					3/24							9/11			WAFR*		
	1967		3/17	11/15b		2/13	8/12									AFR*		
	1968		2/15	(1/3) <sup>c</sup> 8/12		1&2/10 <sup>e</sup>	7/12									BAFR*		
	1969			11/16d		14/14f	8/14											
	1970					11/17												

NOTES:

a. Ratings (e.g., 2/15) should be read, M rated 2nd of 15 rated price comparable models

b. 18" portable: "lower in overall quality"

c. 18" portable

d. 16" portable

e. FM/AM stereo

f. Radio/Phono consoles

g. 1960 & before

\*AFR = Average Frequency of Repair

\*WAFR = Clearly Worse than Average Frequency of Repair

\*SWAFR = Somewhat Worse than Average Frequency of Repair

\*BAFR = Clearly Better than Average Frequency of Repair

\*BAFR = Clearly Better than Average Frequency of Repair

TABLE V  
Advertising Covered as a Percentage of Retailer's  
Purchases from Magnavox

		Matching Formula	
		1:1	2:1 (Magnavox pays 2/3)
	1.8%	3.6%	2.7%
Accrual	2.8	5.6	4.2
Rate	3.8	7.6	5.7
	4.0	8.0	6.0

TABLE VI  
Dealer Quotas for Volume Incentive Plan, 1964-1968

	1964	1965	1966	1967	1968
1. Portion of quota assigned to first six months.	40%	40%	35%	35%	40%
2. Percentage increase in dollar purchases of: <sup>a</sup>					
A. Monochrome TV	(d)	—	10%	-25%	+5%
B. Color TV	(d)	—	None	+25% <sup>e</sup>	+15%
C. Radio, Phonograph	(d)	20%	—	+10%	+10%
D. Color-Stereo Theaters		—	20%	—	
E. Radio, Phonograph, and Monochrome TV		—	20%	—	
F. All TV		20% <sup>b</sup>		—	
G. TOTAL	20%	15%, 20% <sup>c</sup>	20%	25% <sup>e</sup>	20%
Source	File 8822-4-14-3 CX 101	File 8822-4-14-3 CX 109	File 8822-4-5-1 pp124-34	File 8822-4-5-1 pp331-37	File 8822-4-14-3 CX 106

a. For 1964 and 1965 the increase is over the maximum of the previous two years; for 1966 and 1967 it is over the previous year. In 1968, the quota is for the maximum of the previous two years (except for black and whites, where it is only the previous year). In 1964, the color TV quota was 30% for the first six months.

b. At least half must be color TV.

c. The award schedules differ for the two rates. There is an additional bonus for a 50% increase.

d. In 1964 quotas were established for these three categories, but were determined on an individual basis.

e. In November, due to lower than expected sales of color television, Magnavox reduced the color television quota to 15% and the total quota to 20%.

FILE 8822-4-14-3, CX 105.

TABLE VII

## Magnavox Incentive Program Bonuses, 1964-1966

Volume Bracket (in thousands)	Payment in Percent <sup>a</sup>				
	1964	1965A <sup>b</sup>	1965B <sup>c</sup>	1966A <sup>d</sup>	1966B <sup>e</sup>
\$0 - Minimum <sup>f</sup>	0	0	0	0	0
Minimum-\$40,	.75%	.35%	.75%	.75%	1.25%
\$40,-\$80,	1.25%	.60%	1.25%	1.25%	1.75%
\$80,-\$140,	1.50%	.75%	1.50%	1.50%	2.25%
\$140,-\$200,	1.75%	.85%	1.75%	1.75%	2.50%
\$200,-\$300,	2.00%	1.00%	2.00%	2.00%	3.00%
\$300,-\$500,	2.50%	1.25%	2.50%	2.50%	3.75%
\$500,-\$750,	(g)	1.50%	3.00%	3.00%	4.50%
\$750,-\$1,000,		1.75%	3.50%	3.50%	5.25%
\$1,000,-\$1,250,		2.00%	4.00%	4.00%	6.00%
\$1,250,-\$1,500,		2.25%	4.50%	4.50%	6.75%
\$1,500,-\$1,750,		2.50%	5.00%	5.00%	7.50%
\$1,750,-\$2,000,		2.75%	5.50%	5.50%	8.25%
\$2,000,-\$2,250,		3.00%	6.00%	6.00%	9.00%
\$2,250,-\$2,500,		3.25%	6.50%	6.50%	9.75%
\$2,500,-\$3,000,		3.50%	7.00%	7.00%	10.50%

a. The percentage is the *marginal rate*.

b. This schedule held if the dealer met the 15% quota.

c. This schedule held if the dealer met the 20% quota.

d. 1966A for color television only

e. 1966B for other products

f. The minimum was \$20,000 in 1964, \$25,000 in 1965, and \$10,000 in 1966.

g. The schedule in 1964 ends at \$500,000; presumably the 2.5% rate would apply to larger volumes as well.