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Barbara Ann White

University of Baltimore School of Law, bwhite@ubalt.edu

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Black and White Thinking in the Gray Areas of Antitrust: The Dismantling of Vertical Restraints Regulation

Barbara Ann White*

Introduction

In the last twenty years the United States Supreme Court has once again effectively redefined acceptable business behavior in the antitrust arena.¹ The Court's changes reflect, in part, the incursion of

* Associate Professor of Law, University of Houston Law Center. B.A. Mathematics, Hunter College (1969); Ph.D. Economics, Cornell University (1980); J.D. State University of New York at Buffalo (1985). The author thanks the following students of the University of Houston Law Center for their able research assistance at various stages of the development of this Article: Mark Friedman, Class of 1989, Lily Deurmyer and James Kovatch, Class of 1991, and particularly, T. Edwin Walker, Class of 1992. The author also would like to thank Irene Rosenberg and members of the Vanderbilt University School of Law Seminar Series, in particular Cindy Alexander, James Foster, and Jason Johnston for useful comments. This research was supported by the University of Houston Law Foundation Summer Grant Program.

1. The Court's philosophy underlying antitrust decisions certainly has not been constant since the Sherman Act's passage. See Thomas M. Melsheimer, *Economics and Ideology: Antitrust in the 1980s*, 42 STAN. L. REV. 1319, 1319-20 (1990) (reviewing ECONOMICS & ANTITRUST POLICY (Robert J. Lerner & James W. Meehan, Jr. eds., 1989)). Just as different philosophies influence the law in general, so do they influence antitrust law in particular. See Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust—Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936 (1987); James A. Meehan, Jr. & Robert J. Lerner, *The Structural School, Its Critics, and its Progeny: An Assessment*, in ECONOMICS & ANTITRUST POLICY 179 (Robert J. Lerner & James M. Meehan, Jr. eds., 1989) [hereinafter ANTITRUST POLICY]; Timothy J. Waters, *Antitrust Law and Policy: Rule of Law or Economic Assumptions*, in ANTITRUST POLICY, *supra*, at 152; Oliver E. Williamson, *Antitrust Enforcement: Where Has It Been; Where It Is Going*, in INDUSTRIAL ORGANIZATION, ANTITRUST, AND PUBLIC POLICY 41-42 (John U. Craven ed., 1983); see also *infra* text accompanying notes 85-158 (discussing the history of vertical restraints doctrine).

modern efficiency analysis,² an approach strongly influenced by Chicago School proponents³ claiming objective economic reasoning as the basis of their antitrust posture.⁴ Because the Court's adaptation of the economic efficiency standard for evaluating business conduct has not occurred in one fell swoop, decisions in antitrust law seem to vacillate between an older, populist philosophy,⁵ which tends to take a conspiratorial view of corporate activity,⁶ and a more modern

2. See *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (1986) (using economic analysis in recognizing the absence of countervailing economic power to forestall the anticompetitive threat of defendant's horizontal restraint); *National Collegiate Athletic Ass'n (NCAA) v. Board of Regents*, 468 U.S. 85, 100-01 (1984) (using economic analysis in determining that horizontal restraints ordinarily subject to automatic condemnation were necessary to the survival of the product and therefore potentially procompetitive); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 35 (1984) (O'Connor, J., concurring in judgment) (advising the Court to "refocus the inquiry on the adverse economic effects, and the potential economic benefits, that a [tying arrangement] may have"); *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 357 (1982) (Powell, J., dissenting) (applying economic analysis of countervailing power in arguing that anticompetitive horizontal price fixing could not occur in the case at bar); see also Donald I. Baker, *Antitrust Law and Economics at the Political Frontier*, in *ANTITRUST POLICY*, *supra* note 1, at 141 (noting that "[e]conomists have changed the face of antitrust in the quarter century since *Brown Shoe*"); Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1700-01 (1986) (expressing his "skepticism" of antitrust laws in general and arguing that economic analysis is the best way to promote consumer welfare); Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 216 (1985) (stating that "[a]ntitrust academia, the antitrust bar, and the federal judiciary are filled with people who have made serious efforts to learn about price theory and industrial organization"); Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 279 (1987) (supporting the use of economics in antitrust analysis, while expressing concern that too free a use could allow potentially objectionable business behavior).

3. See Harry S. Gerla, *A Micro-Microeconomic Approach to Antitrust Law: Games Managers Play*, 86 MICH. L. REV. 892, 892 (1988) (recognizing that Chicago School economic theory "has become the dominant tool for contemporary antitrust analysis"); William H. Page, *The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, 75 VA. L. REV. 1221 (1989) (evaluating the extensive role and influence of the Chicago School economic models in Supreme Court decisionmaking over the past decade); Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 939 (1979) ("[T]he position of the Chicago School on restricted distribution has become the orthodox academic position. The decision in *Continental T.V., Inc. v. GTE Sylvania Inc.* suggests that it is well on its way to becoming the legal position as well."); see also *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) (relying heavily on the work of leading Chicago School proponents: ROBERT H. BORK, *THE ANTITRUST PARADOX* (1978); John S. McGee, *Predatory Pricing Revisited*, 23 J.L. & ECON. 289 (1980); Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263 (1981)).

4. The views of the Chicago School on antitrust are outlined *infra* note 6, and have been well documented by many of its high profile proponents. See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX* (1978); RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976); Easterbrook, *supra* note 2; Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); Posner, *supra* note 3.

5. See JOE S. BAIN, *BARRIERS TO NEW COMPETITION* (1956); Leonard W. Weiss, *The Concentration—Profits Relationship and Antitrust*, in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (Harvey J. Goldschmid et. al. eds., 1974); Lawrence A. Sullivan, *Antitrust, Microeconomics, and Politics: Reflections on Some Recent Relationships*, 68 CAL. L. REV. 1 (1980).

6. This Article refers to this antitrust perspective as the Modern Populist School. One can view the range of modern antitrust positions among courts and scholars as falling along a continuum. At the poles are the extremes of the Modern Populist and the Chicago views. Originally, the Populist perspective envisioned competition as atomistic. The ideal Populist industry consists of many small firms, each with ready access to the marketplace and each operating independently. This ideal presumably would lead to lower prices and greater output. See, e.g., BAIN, *supra* note 5; Weiss, *supra* note 5. The

economic view, which examines the competitiveness of market forces or the activity's efficiency justification to gauge the legality of the scrutinized conduct.⁷ This inconsistency in the caselaw reflects

Chicago perspective—the intellectual antecedents of which go as far back as the Hamiltonian view of the economy—emphasizes efficiency and economies of scale to achieve lower prices, greater output, and consumer welfare. See, e.g., BORK, *supra* note 4; Easterbrook, *supra* note 2; Posner, *supra* note 3. Although both perspectives are concerned with enhancing society's well-being, the Populists might be characterized as placing greater emphasis on the process of competition as they envision that structure, whereas the Chicago School can be viewed as more result oriented, in which a competitive environment exists as long as existing firms are spurred to improve their products and services by the threat of a potential competitor.

Toward the Populist end exists the concern for concentrations of economic power, while moving in the Chicago direction the primary issue becomes barriers to efficient conduct. The Populists seem willing to sacrifice efficiency to preserve the atomistic economy, whereas the Chicago School is willing to forgo the presence of many firms if they are less efficient than their stronger competitors. The Chicago School also validates efficient corporate strategies even though they may serve as entry barriers to other firms, because a new entrant that is even more efficient than the incumbents will not be barred by these obstacles.

In keeping with the Populist's concern, the Supreme Court in the decades from the 1940s through the 1960s took a more conspiratorial approach in evaluating corporate conduct. See *infra* notes 110-27 and accompanying text. This Modern Populist approach, which meant that cooperation among competitors was highly suspect and efficiency considerations carried very little weight, led to the creation of many of the *per se* illegal rules. See *infra* notes 47 & 48. Industrial concentration also was viewed with great suspicion, leading to the possibility of corporate disassemblage as an antitrust remedy. See, e.g., *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982) (resulting in break-up of AT&T), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). A branch of economic analysis supported this reasoning by arguing that if one could show statistically both industrial concentration and above-average profit rates for an industry, it was reasonable to infer that the firms were engaging in monopolization. This view became known as the Structuralist view and served to buttress the Modern Populist perspective. See *infra* notes 9 & 15. Although this analysis was developed by economists, the bases of their conclusions were not truly drawn from economic reasoning; they had their origins in the Modern Populist perspective. See, e.g., Meehan & Lerner, *supra* note 1.

More recently, some scholars holding antitrust values not very different from the Modern Populist School but who also incorporate modern efficiency analysis into their framework have categorized themselves as the "New Coalition." See generally Symposia, *The Papers Presented at the Arlie House Conference on the Antitrust Alternative*, 76 Geo. L.J. 237; 62 N.Y.U. L. REV. 931 (Eleanor M. Fox & Robert Pitofsky eds., 1987). Much of their writings react to the Chicago School's strong influence on antitrust thinking. See *id.*

Clearly, there are scholars all along the continuum between the Modern Populists and the Chicago School. The closer these scholars are to the Chicago end of the spectrum, the more they tend to emphasize efficiency analysis in their antitrust posture; the closer they are to the Modern Populist end of the spectrum, the more they are concerned with the form and structure of the market, particularly with regard to agreements and economic concentration.

7. The clearest evidence of the Court's oscillation between an emphasis on the Populists' concern for the conspiratorial dimension of business conduct and an efficiency analysis of actual market impact is a series of decisions over the last fifteen years regarding horizontal price agreements. Although horizontal price agreements among competitors have long been held illegal, see *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940), the Supreme Court has vacillated from strict adherence to that standard. For example, in *Broadcast Music, Inc. (BMI) v. Columbia Broadcasting Sys. (CBS)*, 441 U.S. 1 (1979), the Court found that the marketing of virtually every

not only the changing composition of the Court,⁸ but also the extent to which efficiency analysis has been accepted by individual

copyrighted musical composition in the country through one of two defendant organizations did not constitute illegal price-fixing. *Id.* at 4-5, 7. Even though the defendants set the price for all the compositions in their respective collections by issuing only blanket licensing agreements, the Court, relying on efficiency arguments, ruled that there was no antitrust violation. *Id.* at 23-25. Noting that the defendant organizations facilitated the creation of an efficient market for compositions by reducing transaction costs for potential users, *id.* at 20-21, as well as insuring that copyright owners received royalties for the use of their compositions, *id.*, the Court concluded that the defendants' conduct should be assessed under a rule of reason, *id.* at 24-25. See *infra* note 10 for a discussion of the rule of reason. The next year, in *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980) (*per curiam*), the Court returned to a conspiracy focus refusing to consider the efficiency justifications behind an agreement among wholesalers to no longer issue credit to retailers. *Id.* at 646. The Court's decision was based on its conclusion that credit was a part of price, bringing the agreement under the *per se* rule prohibiting illegal price-fixing. *Id.* at 648. The fact that the wholesalers still were engaging in price competition seemed not to matter to the Court in *Catalano*. Four years later, shifting once more to an economic market analysis in *NCAA v. Board of Regents*, 468 U.S. 85 (1984), the Supreme Court decided that a horizontal agreement to restrict supply, an activity resoundingly condemned as a form of *per se* illegal price-fixing since *Socoy-Vacuum* in 1940, should in the case of the NCAA be judged instead under the rule of reason. *Id.* at 100. Although the Court ultimately found that the economic efficiency arguments did not outweigh the restraints on trade imposed by the agreement, *id.* at 120, it reached that decision on the basis of economic reasoning, *id.* at 113-20. Thus, though movement toward an economic analytic approach appears to be the long-term trend, the Court continues to adopt the Modern Populist view periodically.

8. The impact of the Court's changing composition is almost humorously apparent in its treatment of two cases: *Fortner Enterprises, Inc. v. United States Steel Corp.* (*Fortner I*), 394 U.S. 495 (1969), and *United States Steel Corp. v. Fortner Enterprises, Inc.* (*Fortner II*), 429 U.S. 610 (1977). In *Fortner I*, Fortner sued a manufacturer of prefabricated homes and a credit corporation, its wholly owned subsidiary. 394 U.S. at 496-97. The credit corporation made favorable loans available for the purpose of purchasing and developing land in a local area. The caveat was that these loans were made available only to customers who purchased a prefabricated home from the parent corporation to build on the land to be developed. *Id.* at 497. Fortner sued for antitrust violations but the district court granted summary judgment for the defendant. *Fortner Enters., Inc. v. United States Steel Corp.*, 293 F. Supp. 762, 769 (W.D. Ky. 1966), *aff'd*, 404 F.2d 936 (6th Cir. 1968), *rev'd*, 394 U.S. 495 (1969). Noting that the conduct was in fact a tying arrangement, the district court found that the defendant did not have "sufficient market power over the tying product [the favorable credit] and [did not] foreclos[e] a substantial volume of commerce in the tied product [the prefabricated homes]" such as to render the arrangement illegal. See *Fortner I*, 394 U.S. at 497-98.

The Supreme Court disagreed with the district court's ruling, deciding that the dollar amount involved in the tied good constituted substantial foreclosure for purposes of a *per se* illegal tying arrangement. *Id.* at 501. For the majority, the relevant consideration was not that the percentage of the market represented—.00032%—was insignificant, but that the number of dollars involved was not "de minimis." *Id.* at 501-02 & n.1. In addition, the extremely favorable terms indicated that the credit arrangements might be unique and therefore could constitute the economic power necessary to render the tying arrangement illegal. *Id.* at 503-06. The question of uniqueness created a sufficient issue of material fact that the district court's grant of summary judgment was inappropriate, and the case was remanded to the district court. *Id.* at 505-06. The Court noted that, on remand, the defendant should have an opportunity to provide some business justification for its activities, *id.* at 506, though the Court rejected the efficiency and procompetitive arguments offered up until that point, *id.* at 507-10. Justice Byron White filed a dissenting opinion, in which Justice John M. Harlan joined. *Id.* at 510 (White, J., dissenting). Justice Abe Fortas also filed a dissenting opinion, with which Justice Potter Stewart joined. *Id.* at 520 (Fortas, J., dissenting).

In retrospect, it is clear that the defendant's primary purpose was to make the prefabricated homes more attractive by effectively lowering their price. Low-cost financing is one way to do so. The plaintiff, Fortner, obviously hoped to gain access to the low-cost financing for the land without having to buy the home, and brought this suit to achieve

Justices.⁹

The predominating thrust of the Court's use of economic analysis in the antitrust context has been to assess the pro- and anticompetitive effects of a particular business activity under the rubric of the rule of reason.¹⁰ Even though there is a wide range of economic

that end. The Court analyzed the case from a pure Modern Populist perspective, perceiving the competitive loan rates as a unique good with exclusionary impact rather than just a form of price competition.

Not surprisingly, on remand, the district court, following the guidelines set down by the *Fortner I* Court, found that the low-cost loan was indeed unique and that an illegal tying arrangement did exist. See *Fortner II*, 429 U.S. at 613. The defendants appealed to the Supreme Court. In the interim, the membership of the Court had changed substantially. Five Justices had left the bench, Chief Justice Earl Warren, and Justices Hugo Black, William O. Douglas, Harlan, and Fortas. Three of those Justices were in the *Fortner I* majority—Chief Justice Warren, and Justices Black and Douglas. Without them, the new Court discredited the trial evidence indicating that the loan terms were unique. *Id.* at 621-22. The Court also stated that the district court erred in concluding that the loan services constituted significant market power. *Id.* at 617-18. The Court then engaged in a market analysis to show that the loans were simply a form of price competition. *Id.* at 620-22. Thus, whether the Court found the arrangement at issue in the *Fortner* cases to be a potentially illegal tying agreement depended on whether the Court adopted a Modern Populist or an economic efficiency-market perspective.

9. A good example of the extent to which a Justice will refuse to consider the overriding market dynamics can be seen in *United States v. Container Corp.*, 393 U.S. 333 (1969), a case typically viewed as a prime example of the Structuralist perspective of antitrust considerations. See *supra* note 6. Justice Douglas, writing for the majority, presented an excellent modern economic analysis demonstrating that the market in which the defendants operated was highly competitive and had been for some time. *Container Corp.*, 393 U.S. at 336-37. The market dynamics were so competitive that the conduct under scrutiny—a seller phoning some of his competitors to find out their selling price on a particular good—had virtually no hope of leading to horizontal price-fixing. See *infra* notes 258-60 and accompanying text. In spite of this compelling evidence that he himself articulated, Justice Douglas reached the opposite conclusion. Justice Douglas focused on the potential conspiracy element: because the conduct involved two sellers communicating price to each other, the conduct was illegal. *Container Corp.*, 393 U.S. at 337-38. The tone of his opinion was so strong that it easily can be interpreted as ruling that communication of price information between sellers is in itself *per se* illegal, an extreme position the Court never before had taken. See *id.* at 338 (stating that "[p]rice is too critical, too sensitive a control to allow it to be used in even an informal manner to restrain competition"). Justice Fortas was sufficiently concerned that he wrote a concurring opinion to make clear that he did not hold that view. *Id.* at 338-40 (Fortas, J., concurring). One easily can conclude that even in the context of an overwhelming competitive market climate, Justice Douglas considered that factor irrelevant when evaluating the likelihood that communication could convert to a successful horizontal price restraint.

10. See, e.g., *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605-11 (1985) (using economic analysis to determine whether a firm's decision not to cooperate with a competing firm was sufficiently procompetitive to overcome its anticompetitive effects); *NCAA v. Board of Regents*, 468 U.S. 85, 104-17 (1984) (assessing the economic impact of horizontal agreement to limit output and fix price in determining whether the potential anticompetitive effects were outweighed by the procompetitive benefits); *BMI v. CBS*, 441 U.S. 1, 5, 24 (1979) (finding blanket license system fixing prices at the horizontal level not subject to analysis because alternatives were economically inefficient). Rule of reason analysis, the weighing and balancing of the pro- and anticompetitive effects of scrutinized conduct, is one of the two approaches courts take to evaluate business activity. The other approach is to deem certain business activity *per se* illegal. See *infra* notes 46-47 and accompanying text. PHILLIP AREEDA & LOUIS

antitrust perspectives,¹¹ of which the Chicago School is only one,¹² there has been little disagreement among supporters concerning the Court's use of economics criteria.¹³ For the most part, the effect has been to undo many of the legal barriers to corporate conduct erected by the Modern Populist School¹⁴ (often through declarations of per se illegality)¹⁵ that economic analysts generally consider inefficient.¹⁶

The question now arises whether some recent applications of economic efficiency analysis lay the groundwork for the elimination of judicial antitrust supervision altogether; a result, some argue, that is the true goal of the Chicago School.¹⁷ Although the Chicago School

KAPLOW, ANTITRUST ANALYSIS 187-88 (4th ed. 1988); ELEANOR M. FOX & LAWRENCE A. SULLIVAN, CASES AND MATERIALS ON ANTITRUST 282-307 (1989); E. THOMAS SULLIVAN & HERBERT HOVENKAMP, ANTITRUST LAW, POLICY AND PROCEDURE 156 (2d ed. 1989).

11. See, e.g., PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW (1978); F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE (1970); Richard Schmalensee, *The New Industrial Organization and the Economic Analysis of Modern Markets*, in ADVANCES IN ECONOMICS THEORY 253 (Werner Hildenbrand ed., 1982). For an antitrust analysis drawn from recent theoretical economic developments, see Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986). But see Herbert Hovenkamp, *Antitrust Policy, Restricted Distribution, and the Market for Exclusionary Rights*, 71 MINN. L. REV. 1293 (1987) (critiquing Krattenmaker & Salop). For other new economic theoretical developments relevant to antitrust but distinct from the Chicago School perspective, see C.C. VON WEIZSACKER, BARRIERS TO ENTRY: A THEORETICAL TREATMENT (1980); David M. Kreps & Robert Wilson, *Reputation and Imperfect Information*, 27 J. ECON. THEORY 253 (1982); Paul Milgrom & John Roberts, *Predation, Reputation, and Entry Deterrence*, 27 J. ECON. THEORY 280 (1982).

12. See *supra* note 3.

13. For example, scholars have supported the Supreme Court's use of economic analysis to avoid condemning a tying arrangement that created efficiencies in Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984). See, e.g., Henry N. Butler et al., *The Futility of Antitrust Attacks on Tie-In Sales: An Economic and Legal Analysis*, 36 HASTINGS L.J. 173, 174 (1984) (presenting a detailed economic analysis showing that firms can generate greater profits with legal pricing strategies than would be achieved through ties, thus rendering a per se illegal rule for tying arrangements unnecessary); Kurt A. Strasser, *An Antitrust Policy for Tying Arrangements*, 34 EMORY L.J. 253, 254 (1985) (arguing that "[a] coherent antitrust policy must distinguish procompetitive from anticompetitive uses of tying"); Donald F. Turner, *The Durability, Relevance, and Future of American Antitrust Policy*, 75 CAL. L. REV. 797, 805-06 (1987) (asserting that the Court should narrow further the scope of prohibited tying arrangements to those that have obvious anticompetitive effects).

14. See *supra* note 6.

15. "The [Warren] Court favored the rule of illegality over the broader rule of reason analysis." E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 73 (1988). The Warren Court, with its Structuralist approach to antitrust considerations, represented the height of the Modern Populist School. See Lawrence A. Sullivan, *Monopolization: Corporate Strategy, the IBM Cases, and the Transformation of the Law*, 60 TEX. L. REV. 587, 595 (1982) ("[T]hroughout the 1960s . . . the structural consensus continued to dominate public, professional, and academic discussion of antitrust issues. Courts continued to deal with the monopolization offense primarily by analyzing market definitions, share determinations, and barriers to entry."); see also *supra* note 6.

16. See, e.g., *Jefferson Parish*, 466 U.S. at 35 (O'Connor, J., concurring in judgment) (finding no antitrust violation because the procompetitive effects outweighed the anticompetitive effects of the tying arrangement, despite the fact that tying arrangements were declared per se illegal during the height of the Modern Populist era).

17. See, e.g., Fox & Sullivan, *supra* note 1, at 957 (arguing that "[d]espite the consensus that economics can play a supporting role, the Chicago School, in the name of law and economics, has waged ideological warfare, assaulting antitrust itself"); Melsheimer, *supra* note 1, at 1335 (stating that "in the hands of Chicago School proponents, economics has become an engine for an ideology hostile to the operation of antitrust law");

does advocate a limited reach for antitrust law, it still holds that business activity should be condemned if it restricts output.¹⁸ Nevertheless, whenever proponents of that philosophy analyze particular corporate behavior, they invariably conclude that the conduct is market driven and is, therefore, necessarily competitive.¹⁹ Chicago School analysts often give scholars the impression of instinctively condoning business strategies and then developing post-hoc efficiency arguments to justify those positions, rather than using economic reasoning to reach an objective evaluation.²⁰ As a result, an increasing number of scholars, whether or not they support the use of modern economic thought in the courts, perceive the Chicago School position as being adverse to any antitrust regulation at all.²¹

If the Chicago style of economic reasoning leads courts to legal conclusions that, for all intents and purposes, eliminate antitrust restrictions on business conduct, then an examination of the economic validity of such analyses is imperative. If close economic scrutiny does not support the effective abandonment of antitrust evaluation of corporate activity, then it behooves those scholars who support the use of economics in the courtroom to distance themselves more openly from the Chicago perspective.²²

This Article examines one area of antitrust law—vertical restraints—that not only reflects the changing attitudes of the Court, but is also the subject of recent advances in economic theory that shed new light on those antitrust concerns. Vertical restraints are

Stephen D. Susman, *Business Judgment vs. Antitrust Justice*, 76 GEO. L.J. 337, 345 (1987) (asserting that the Supreme Court has been influenced by the Chicago School such that it is "abandoning any attempt to achieve the political goals of antitrust regulation").

18. See, e.g., BORK, *supra* note 4, at 179 (arguing that only conduct that restricts output so as to raise prices without efficiency gains should be prohibited by the antitrust laws); Easterbrook, *supra* note 4, at 39 (suggesting that antitrust law should be like a system of filters that remove from scrutiny efficient conduct and "pass only practices that are likely to reduce output and increase price").

19. See, e.g., Fox & Sullivan, *supra* note 1, at 969.

20. See, e.g., Eleanor M. Fox, *Consumer Beware Chicago*, 84 MICH. L. REV. 1714, 1715-16 (1986) ("Chicago's critical contention and presumption that firms act efficiently is not a descriptive observation that produces the conclusion that almost everything is legal. It is simply argument supporting the normative claim that people (including firms) should be left free to act and that there is almost never a higher social interest."); Hovenkamp, *supra* note 2, at 234 (contending that "the Chicago School's claim of a unified, internally consistent, and nonpolitical antitrust policy rests on premises whose soundness and application to the real world are not self-evident").

21. See Hovenkamp, *supra* note 2, at 226-31; Page, *supra* note 3, at 1223.

22. Some economics-oriented scholars already have. See, e.g., Hovenkamp, *supra* note 2, at n.* ("The author admits a great admiration for Chicago School antitrust policy, and confesses that he has been a fellow traveler for some time. Nevertheless, he believes that the Chicago School generally did a much better job of defending its position when it was a tiny squad of embattled outsiders instead of a triumphant division."); Krattenmaker & Salop, *supra* note 11 (using economic analysis drawn from theoretical models to show circumstances when exclusionary conduct can lead to a lowering of consumer welfare). For those economics-oriented scholars who were always in some disagreement with the Chicago school, see *supra* note 11.

restrictions imposed by manufacturers in governing the conduct of the distributors of their products.²³ The Supreme Court's rulings in this area over the last two decades increasingly have incorporated modern economic efficiency factors as part of the expanding use of the rule of reason,²⁴ a move much applauded by economics-oriented antitrust scholars.²⁵ The two most recent cases, however, *Business Electronics Corp. v. Sharp Electronics Corp.*,²⁶ decided in 1988, and *Atlantic Richfield Co. (ARCO) v. USA Petroleum Co.*,²⁷ decided in 1990, while giving the appearance of continuing that trend, seem, upon closer examination, to be shifting more in the direction of invoking economic reasoning to effectively dismantle antitrust regulation of vertical restraints altogether, a position openly supported by the Chicago School.²⁸ Through its antitrust decisions of the last two years, the Court has made any potential finding of illegality for vertical price restraints remote, if not nonexistent.²⁹ In other words, the ultimate effect of the *Sharp* and *ARCO* decisions, which address the price-fixing component of vertical restraints, may not be only to increase the proportion of vertical restraints that are now judged under the balancing approach of the rule of reason, an interpretation held by many experts,³⁰ but also to render some, if not all, vertical price-fixing de facto per se legal.³¹

23. For purposes of this Article, the term "distributors" refers to all business entities that act as commercial intermediaries between manufacturers and the ultimate consumer. Thus, distributors includes wholesalers, distributors, dealers, and retailers. Frequently, these terms are used interchangeably, as exemplified by the cases on vertical restraints.

24. See *infra* text accompanying notes 130-212.

25. For example, a number of scholars approved of the Court's decision, in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), to move, for efficiency reasons, vertical nonprice restraints to the rule of reason category. See, e.g., Milton Handler, *Reforming the Antitrust Laws*, 82 COLUM. L. REV. 1287, 1301 (1982) (stating that "[t]he errors of *Schwinn* have been remedied by *Sylvania*, in which the Court announced that a rule of reason would thenceforth govern the legality of all non-price vertical restraints"); Herbert Hovenkamp, *Vertical Restrictions and Monopoly Power*, 64 B.U. L. REV. 521, 522 (1984) (arguing that the courts should condemn a manufacturer's restrictive behavior only "when the restrictions are used to facilitate inefficient price discrimination"); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 5 (1977) (praising the economic analysis used by the Supreme Court to determine when conduct is anticompetitive).

26. 485 U.S. 717 (1988).

27. 110 S. Ct. 1884 (1990).

28. See, e.g., Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 135 (1984) (asserting that all vertical restrictions, including price, are the same and as a class should not "be a subject of serious antitrust attention"); Thomas A. Piraino, Jr., *The Case for Presuming the Legality of Quality Motivated Restrictions on Distribution*, 63 NOTRE DAME L. REV. 1, 34 (1988) (stating that per se legality would free manufacturers to improve the quality of their product and enhance consumer welfare); Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 8 (1981) (arguing that declaring "purely vertical restrictions on distribution" legal would create a judicially manageable standard compared to the rule of reason or the illegal rule).

29. See *infra* notes 189-242 and accompanying text.

30. See *infra* note 75.

31. No formal pronouncement of per se legality has yet been handed down by the Court. This Article demonstrates however, that Justice Antonin Scalia's structural definition of per se illegality for vertical price restraints in *Sharp*, without more, in fact creates a category of per se legality. See *infra* notes 213-25 and accompanying text.

In this Article I present a two-pronged analysis of vertical restraints, one in law³² and one in economics.³³ By tracing the checkered legal history of vertical restraints,³⁴ I show the marked changes recent antitrust decisions have wrought, in particular, by comparing the legal standards expressed by the Supreme Court in *Monsanto Co. v. Spray-Rite Service Corp.*³⁵ with those in *Sharp* and *ARCO*.³⁶ If through the latter two cases the Court has, for all practical purposes, created a category of per se legality for vertical price restraints, which I believe to be the case, then it would not be unreasonable to expect the Court to proceed in the same fashion with respect to vertical nonprice restraints in the future.³⁷

After assessing the current legal status of vertical restraints through market analyses, I then demonstrate that the economic reasoning justifying their per se legal treatment is not as compelling as previously believed. I show this in two respects. One evaluation stems from recent advances in economic theory exploring the dynamics underlying the manufacturer's decision process when selecting a method of product distribution. By drawing on those developments, I identify market scenarios not previously considered, in which the anticompetitive effects of vertical price restraints on certain distribution strategies raise new and legitimate antitrust concerns.³⁸ A second inquiry reexamines the economic issue that initially gave rise to arguments in favor of the legalization of vertical price restraints, that is, the phenomenon of price-discounting retailers who are also free riders.³⁹ Some commentators have argued that manufacturers should be able to impose vertical price restraints to protect against the dealer erosion that free-riding precipitates.⁴⁰

32. See *infra* text accompanying notes 159-242.

33. See *infra* text accompanying notes 243-331.

34. See *infra* text accompanying notes 77-242.

35. 465 U.S. 752 (1984); see *infra* text accompanying notes 159-88.

36. See *infra* text accompanying notes 193-242.

37. A survey of thirty court of appeals decisions since *Sylvania* in cases of dealer termination shows an already existing propensity to rule for the defendant when the rule of reason is used. Of the thirty opinions, twenty-four or 80% favored the defendant on the antitrust claims. Many of the opinions were affirmations of summary judgments or directed verdicts in favor of the defendant. The circuits with the most antitrust activity were the Fifth (six decisions for the defendant and none for the plaintiff) and the Ninth (seven decisions for the defendant and none for the plaintiff). See Appendix for methodology and list of cases.

38. These scenarios are of a very different dimension, see *infra* notes 282-310 and accompanying text, from the economic concerns regarding cartelization that already have been raised about vertical price restraints, see *infra* text accompanying notes 258-81.

39. See *infra* text accompanying notes 159-65.

40. See, e.g., SULLIVAN & HARRISON, *supra* note 15; at 118; Kenneth Kelly, *The Role of the Free Rider in Resale Price Maintenance: The Loch Ness Monster of Antitrust Captured*, 10 GEO. MASON U. L. REV. 327, 338-39 (1988); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 91 (1960). But see Willard F. Mueller, *The Sealy Restraints: Restrictions on Free Riding or Output?*, 1989 WIS. L. REV. 1255; see also *infra* text accompanying notes 311-31.

Reaching a different conclusion, this Article demonstrates that either the manufacturer can achieve those same ends through less trade-restrictive business methods that may, in addition, enhance consumers' satisfaction, or, that the strategies themselves, from an economics perspective, are not worthy of protection.⁴¹

Together, both economic analyses, that of the manufacturer's distribution choices and that of the free rider phenomenon, signify that unfettered freedom for manufacturers to impose whatever vertical arrangements they choose actually can foster lower efficiency levels and consumer welfare, the primary economic measures used to evaluate antitrust policy. These results are at variance with those of the Chicago School and indicate the need for more subtle, yet well-defined, antitrust treatment of vertical restraints than per se legal rules offer. The conclusions of this Article's market evaluations demonstrate further that the rigidity created by per se illegal treatment of vertical price restraints also lowers consumer welfare when applied to certain commonly occurring manufacturer-retailer relationships. Given that neither per se illegal nor per se legal rules for vertical price restraints have the flexibility to make the crucial distinctions between a manufacturer's pro- and anticompetitive conduct, this Article argues for the application of a rule of reason standard that incorporates those features of market structure that economic reasoning indicates will ensure procompetitive impact.

Part I of this Article gives an overview of recent developments and debates in vertical restraints antitrust law. Part II shows that the development of vertical restraints antitrust law reflects the fact that, historically, the Supreme Court's philosophy for determining antitrust violations has gone through several transformations. Part III shows how the Court's decision to give separate antitrust treatment for nonprice restraints represents one of those transformations. The opinions in that period demonstrate the struggle between the then-predominant Modern Populist philosophy and the emerging efficiency-market approach. Part IV delineates the conundrum created by the Court in *Monsanto* through its efforts to accommodate the Populists' concern for preventing price-fixing conspiracies while emphasizing the economic arguments regarding free-riding. Part V presents and analyzes the *Sharp* opinion, showing how that decision may in fact create categories of per se legality for vertical price fixing. Part V also shows how *ARCO*, when read in conjunction with the Court's pronouncements in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,⁴² furthers the movement towards per se legality. Part VI then addresses the viability of the economic arguments supporting per se legality for vertical price restraints in three sections. The first section reviews the traditional concerns that vertical price-fixing can facilitate horizontal price-fixing agreements, also known

41. See *infra* text accompanying notes 311-31.

42. 475 U.S. 574 (1986).

as cartelization. The second section describes more complex circumstances in which, if vertical price restraints were permitted, industry monopoly pricing could occur without the presence of any cartel agreements, express or implied. By applying this analysis to a more generalized market framework, this section shows how vertical price-fixing not only facilitates such monopoly pricing but also forestalls intrabrand price competition, a particularly important market dynamic in this case, one that otherwise would counterbalance the industry's monopoly pricing tendencies. Ironically, previous economic analysis of vertical restraints law has treated intrabrand price competition as a relatively unimportant phenomenon.⁴³ It has been primarily the Modern Populist School that has fought for its protection in general.⁴⁴ The second section demonstrates, however, that per se illegal treatment of vertical price restraints also can prevent procompetitive impacts; in certain instances, it actually can prevent a lowering of prices that otherwise might occur. The third section evaluates the argument that manufacturers should be allowed to use vertical price restraints as a means of enforcing permissible non-price restraints and prevent free riders. This section shows that consumer welfare actually would be better served if manufacturers used other methods and, in the circumstances when that was not possible, society would be better off without those restraints. Part VII concludes this Article with some remarks on the problems created by the extreme positions of both the Modern Populists and the Chicago School proponents, and advocates the benefits of taking the middle road.

43. See Ernest Gellhorn & Teresa Tatham, *Making Sense Out of the Rule of Reason*, 35 CASE W. RES. L. REV. 155, 171 (1984-85) (noting that "the Court's opinion in *Sylvania* clearly indicates that a mere showing of an intrabrand impact is not enough to find a pernicious effect on competition"); Wesley J. Liebler, *Intrabrand "Cartels" Under GTE Sylvania*, 30 UCLA L. REV. 1, 5 (1982) (stating that intrabrand restraints should be allowed because they do not act to restrict output); E. Thomas Sullivan, *On Nonprice Competition: An Economic and Marketing Analysis*, 45 U. PITT. L. REV. 771, 785 (1984) (recognizing that the Supreme Court has rejected the assumption that lower prices increase the quality of goods and services in the area of intrabrand competition). For cases examining the role of intrabrand competition versus interbrand competition, see *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 726-27 (1988); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 56 (1977).

44. See John J. Flynn, *The "Is" and "Ought" of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Corp.*, 71 CORNELL L. REV. 1095, 1131 (1986) (stating that "[t]he exercise of vertical restraints often increases prices to consumers by curbing or abolishing intrabrand competition"); Robert Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1, 33 (1978) (arguing that "rule of reason treatment in an area like non-price vertical restraints, involving an effort to qualify the trade off between lost intra-brand competition and enhanced inter-brand competition, is largely an effort to measure the unmeasurable"). For opinions critical of the intrabrand-interbrand trade-off, see *Sharp*, 485 U.S. at 748-49 (Stevens, J., dissenting); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967); *White Motor Co. v. United States*, 372 U.S. 253, 278 (1963) (Clark, J., dissenting).

I. Vertical Restraints Law: Developments and Debates

Recent antitrust history divides manufacturer regulation of dealer activities into two categories: those involving restraints on the dealers' sales price, and those involving restraints on activities other than dealer pricing, such as dealers' access to certain territories or particular customers.⁴⁵ Historically, vertical price restraints have been treated as *per se* illegal.⁴⁶ The *per se* rule applies to corporate behavior that a court deems so inherently undermining of competitive market forces in general that it will not consider any efficiency or competition justifications of a particular case.⁴⁷ The strongest advocate for using *per se* illegal categories is the Modern Populist School.⁴⁸ The Modern Populists argue that *per se* rules conserve judicial resources and provide certainty for the business community.⁴⁹

45. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977).

46. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911); see *infra* text accompanying notes 85-92.

47. *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 351 (1982) (holding that agreement among doctors to set maximum fees for insured patients was *per se* illegal notwithstanding proffered procompetitive justifications); *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 650 (1980) (*per curiam*) (holding that an agreement between competitors to eliminate credit was "one form of price-fixing [that has] been adjudged to lack any 'redeeming virtue,' [thus being] conclusively presumed illegal without further examination under the rule of reason"); *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 608, 610-11 (1972) (ignoring claims of beneficial economic effects in holding horizontal territorial restraint by an association of retailers to be a *per se* illegal restraint); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 213 (1951) (holding that an agreement to set maximum prices was *per se* illegal); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940) (stating that "price-fixing agreements are unlawful *per se* under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense").

48. Of the five categories of restraints the Court has declared *per se* violations of the Sherman Act, 15 U.S.C. §§ 1-7 (1988), four occurred during the Modern Populist era. See *Topco*, 405 U.S. 596 (horizontal market division); *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (group boycotts); *International Salt Co. v. United States*, 332 U.S. 12 (1947) (tying arrangements); *Socony-Vacuum*, 310 U.S. 150 (horizontal price-fixing). The fifth *per se* illegal category is vertical price-fixing, established in 1911 in *Dr. Miles*, 220 U.S. 373. On occasion, some members of the Court tended toward *per se* rules so strongly that concurring Justices felt compelled to clarify that the Court did not intend to go that far. See, e.g., *United States v. Container Corp. of America*, 393 U.S. 333, 338-40 (1969) (Fortas, J., concurring) (objecting to the implications of Justice Douglas' majority opinion that the mere one-on-one exchange of price information was in itself *per se* illegal). For a more extensive discussion of Justice Douglas' opinion, see *supra* note 6. For a discussion of the Warren Court perspective, see *supra* note 14.

49. See, e.g., Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1489 (1983) ("Per se rules represent a recognition that (1) antitrust trials, absent a *per se* approach, are long, expensive, and complex, (2) efficient enforcement of the antitrust laws is a justifiable policy goal, and (3) there is a virtue in telling businessmen accurately and precisely the location of legal limits on business conduct."); see also *Topco*, 405 U.S. at 607 ("Th[e] principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation . . .") (quoting *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958)). For a discussion of *Topco* as a Modern Populist case, see Barbara A. White, *Countervailing Power in Antitrust Law and Economics: New Directions for Restraint of Trade Analysis*, 1992 DUKE L.J. (forthcoming Feb. 1992).

Nonprice vertical restraints, on the other hand, are evaluated under the rule of reason.⁵⁰ Rule of reason analysis, the antitrust alternative to per se illegal categorization, weighs the pro- and anticompetitive effects of corporate conduct in the specific context in which it arises.⁵¹ The rule of reason can permit business restraints with strong procompetitive effects to be upheld, whereas if the same conduct were categorized as per se illegal, it automatically would be condemned. In recent times, rule of reason analysis has provided the flexibility to incorporate many of the developments in modern economic theory that assist courts in refining their assessments of competitiveness in the marketplace.⁵²

The Court's first intimation that it might make a distinction between the antitrust treatment of vertical price and nonprice restraints was not realized immediately.⁵³ In the conflict between the Modern Populist philosophy and the economic efficiency approach, the former temporarily prevailed, keeping nonprice restraints in the

50. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

51. In *Standard Oil Co. v. United States*, 221 U.S. 1 (1911), the Court developed the standards for evaluating business activities as reasonable or unreasonable restraints of trade based on balancing the restraint's pro- and anticompetitive effects. The opinion labeled this approach the rule of reason. *Id.* at 66. It is often considered the predominating mode of antitrust assessment in the courts. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988) (noting that "there is a presumption in favor of a rule-of-reason standard [and] that departure from that standard must be justified by demonstrable economic effect"); Rudolph J. Peritz, *The "Rule of Reason" in Antitrust Law: Property Logic in Restraint of Competition*, 40 *HASTINGS L.J.* 285, 285 (1989) ("[T]he Supreme Court's adoption of the 'rule of reason' in 1911 represents the emergence of modern antitrust law.").

52. Of course, one of the conflicts between the Modern Populist School and the advocates of the use of economic analysis is the definition of what constitutes working competition. Generally, the Modern Populist School focuses on business conduct that restricts others' entrance into an industry or that concentrates economic power. See, e.g., Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 *CORNELL L. REV.* 1140, 1154 (1981) (defining the goals of antitrust as "the commitment to power dispersion, economic opportunity, and competition as market"); Robert Pitofsky, *The Political Content of Antitrust*, 127 *U. PA. L. REV.* 1051, 1051 (1979) (arguing that an antitrust policy focusing exclusively on economic concerns would lead to "an economy . . . dominated by a few corporate giants"); Sullivan, *supra* note 5, at 4 (praising the Warren Court for having a concept of competition that included "easing market access, protecting dealer independence, promoting good faith in transactions, and correcting extreme disparities in bargaining power"). Advocates of economic analysis primarily are concerned with conduct that is efficient (that is, allowing more output at a lower cost) and that could not prevent other producers from competing through lower prices. See, e.g., AREEDA & TURNER, *supra* note 11, § 103, at 7 (arguing that "[t]he economic objective of a pro-competitive policy is to maximize consumer economic welfare through efficiency in the use and allocation of scarce resources"); Herbert Hovenkamp, *Distributive Justice and the Antitrust Laws*, 51 *GEO. WASH. L. REV.* 1, 28 (1982) (acknowledging that antitrust, as an economics-oriented area of the law, can be more concerned with efficiency than other societal values); Sullivan, *supra* note 43, at 798 (arguing that courts should focus on an agreement's effect on output and should not limit its analysis to the price factor).

53. In *White Motor Co. v. United States*, 372 U.S. 253 (1963), the Supreme Court first suggested such a possibility, although it did not so rule. *Id.* at 261-64.

per se illegal category for several years.⁵⁴ Eventually, however, in response to severe criticism from scholars arguing that many vertical nonprice restrictions served important efficiency purposes and therefore were not deserving of automatic condemnation,⁵⁵ the Supreme Court decided, in *Continental T.V., Inc. v. GTE Sylvania Inc.*⁵⁶ to apply rule of reason analysis to those cases instead.⁵⁷ The implications of *Sylvania* were not only that the Court would consider the overall pro- and anticompetitive effects to determine whether such restraints violated the Sherman Act,⁵⁸ but also that it would do so through an efficiency analysis.⁵⁹ Restraints involving price, however, remained per se illegal.⁶⁰

Since *Sylvania*, increasing concern over the phenomenon of free riders has stimulated debate as to whether vertical price restraints also can have a predominately procompetitive effect.⁶¹ Free riders are retailers who discount their prices and reap the benefit of other retailers' efforts to stimulate consumer demand for a manufacturer's product without contributing to the costs.⁶² Such activities make other retailers reluctant to undertake the additional efforts, thereby giving manufacturers an incentive to impede the free rider.⁶³ Imposing vertical price restraints is one means to prevent free riding.

An expanding number of economists and antitrust scholars assert that the elimination of free riders can benefit the consumer as well as the manufacturer, and therefore ultimately may be procompetitive.⁶⁴ According to this view, the services that manufacturers want dealers to provide enhance the quality of the product to the consumer. Because resale price maintenance (that is, setting a minimum price below which dealers cannot charge at the retail level) is

54. See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967).

55. See William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and its Aftermath*, 81 HARV. L. REV. 1419 (1968); Earl E. Pollock, *Alternative Distribution Methods After Schwinn*, 63 NW. U. L. REV. 595 (1968); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975).

56. 433 U.S. 36 (1977).

57. *Id.* at 57-59.

58. 15 U.S.C. §§ 1-7 (1988).

59. See *Sylvania*, 433 U.S. at 57-59 (noting the "substantial scholarly and judicial authority supporting the[] economic utility" of nonprice vertical restrictions, while noting also that "[t]here is relatively little authority to the contrary").

60. *Id.* at 51 n.18.

61. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 728 (1988) (stating that manufacturers have a legitimate interest in promoting the quality of their product through services provided by their dealers); James W. Meehan, Jr. & Robert S. Lerner, *A Proposed Rule of Reason for Vertical Restraints on Competition*, 26 ANTITRUST BULL. 195, 206 (1981) (stating that to "induc[e] the desired behavior from independent dealers, manufacturers may adopt vertical restrictions in order to obtain from dealers the investment in training and facilities, the performance of services, and the maintenance of product quality that will yield maximum profits to manufacturers"); Piraino, *supra* note 28, at 6.

62. See Telser, *supra* note 40, at 91.

63. See *id.* at 91-92.

64. Easterbrook, *supra* note 28, at 148; Kelly, *supra* note 40, at 329; Telser, *supra* note 40, at 89-90.

one effective means to assure that services will be provided,⁶⁵ and because resale price maintenance can be a form of vertical price-fixing, some scholars have argued that vertical price-fixing should be subject to the rule of reason standard so as to permit those restrictions that promote efficiency.⁶⁶ On the other hand, the Modern Populist School holds that the potential anticompetitive effects of vertical price-fixing are so severe—because of the restriction on competition among the dealers—that it should remain in the per se illegal category.⁶⁷ Then there are the Chicago School commentators, who argue that not only should vertical price-fixing be taken out of the per se illegal category, but that it, along with all other vertical restraints, should be deemed per se legal, and thus not come under antitrust scrutiny at all.⁶⁸

In *Business Electronics Corp. v. Sharp Electronics Corp.*,⁶⁹ and *ARCO v. USA Petroleum*,⁷⁰ despite pressure to the contrary,⁷¹ the Supreme Court maintained its formal position that vertical price-fixing is subject to per se condemnation.⁷² These holdings nevertheless, at the very least, narrowed the reach of antitrust laws with respect to vertical price restraints. The Court in *Sharp* held that for conduct to be considered vertical price-fixing, it had to contain an agreement as to specific price or price levels.⁷³ In *ARCO*, the Court ruled that a plaintiff could not claim antitrust injury from the illegal vertical price-fixing activities of a competitor unless the plaintiff also could show that the activities constituted predatory pricing.⁷⁴ The Court's analyses in these two cases have led many scholars to conclude that a substantial portion of vertical price-fixing now effectively falls

65. To understand how resale price maintenance can ensure that retailers provide the services the manufacturer desires, see *infra* text accompanying notes 311-31.

66. See, e.g., Tyler A. Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way Out?*, 67 VA. L. REV. 1457, 1465-66 (1981); Betty Bock, *An Economist Appraises Vertical Restraints*, 1985 ANTITRUST BULL. 117, 136-37, 140-41; F.M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 687, 706 (1983); Oliver E. Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transactions Cost Approach*, 127 U. PA. L. REV. 953, 992-93 (1979).

67. See, e.g., Pitofsky, *supra* note 50, at 1488 (arguing that resale price agreements "completely eliminate price flexibility at the dealer level and may stabilize higher prices at the manufacturer level"). For an argument in support of the per se rule on economic grounds, see Comanor, *supra* note 55, at 1001 (advocating the per se illegal rule in the interest of "judicial economy" even if some procompetitive behavior becomes prohibited).

68. See BORK, *supra* note 4, at 288; Easterbrook, *supra* note 28, at 135; Piraino, *supra* note 28, at 6; Posner, *supra* note 28, at 8.

69. 485 U.S. 717 (1988).

70. 110 S. Ct. 1884 (1990).

71. See, e.g., *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 n.7 (1984) (noting that several amicus briefs recommending abandoning per se illegality for resale price maintenance had been filed).

72. *ARCO*, 110 S. Ct. at 1889 n.5; *Sharp*, 485 U.S. at 736.

73. *Sharp*, 485 U.S. at 735-36.

74. *ARCO*, 110 S. Ct. at 1892.

under rule of reason scrutiny.⁷⁵ A closer analysis of the cases in their historical context indicates that the Court may in fact have gone further, creating categories of per se legality for vertical price restraints.⁷⁶

II. Vertical Price Restraints Traditions

One can view the history of vertical price restraints as reflecting the Court's changing perception as to what constitutes an undermining of the competitive process, an objective it understood the Sherman Act⁷⁷ was designed to prevent.⁷⁸ The caselaw indicates that initially, the Court made distinctions between permissible and impermissible vertical restraints on the basis of laissez-faire freedom of contract principles.⁷⁹ In the next era the Court evaluated vertical restraints by looking at the totality of the circumstances to determine the extent to which trade had been restrained.⁸⁰ It then turned toward a Modern Populist view that emphasized whether an agreement existed without much regard for the actual impact on

75. See, e.g., Roger D. Blair & Gordon L. Long, *Albrecht After ARCO: Maximum Resale Price Fixing Moves Toward The Rule of Reason*, 44 VAND. L. REV. 1007 (1991); Jean W. Burns, *Rethinking the "Agreement" Element in Vertical Antitrust Restraints*, 51 OHIO ST. L.J. 1, 26-28 & n.190 (1990); Dennis O. Dougherty, Note, 38 CATH. U. L. REV. 963, 985 (1989); Thomas A. Piraino, Jr., *Sharp Dealing: The Horizontal/Vertical Dichotomy in Distributor Termination Cases*, 38 EMORY L.J. 311, 315 (1989). Although the preceding authors are critical of what they see as the Court's failure to achieve its purported goals, they do not agree as to what the Court's purported goals were. For reactions of various members of the Antitrust Bar, see Ky. P. Ewing, Jr., *Antitrust in the 100th Congress: Issues, Rhetoric, Reality*, 2 ANTITRUST 33, 36 (1987); Charles F. Rule & David L. Meyer, *Doom For Discounters? Let Consumers Choose Where to Shop*, N.Y. TIMES, May 15, 1988, § 3, at 2.

76. See *infra* text accompanying notes 189-242.

77. 15 U.S.C. §§ 1-7 (1988).

78. See, e.g., *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (stating that "[t]he true test of legality is whether restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition"); *United States v. Joint Traffic Ass'n*, 171 U.S. 505, 577 (1898) (stating that "[t]he natural, direct and immediate effect of competition is, however, to lower rates, and to thereby increase the demand for commodities, the supplying of which increases commerce, and an agreement, whose first and direct effect is to prevent this play of competition, restrains instead of promoting trade and commerce"). In *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945), often cited by the Supreme Court, Judge Learned Hand speculated on Congress' insight behind the Sherman Act: "It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the directions of a few." See also *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767 (1984) ("It is not enough that a single firm appears to restrain trade unreasonably, for even a vigorous competitor may leave that impression. For instance, an efficient firm may capture unsatisfied customers from an inefficient rival, whose own ability to compete may suffer as a result. This is the rule of the marketplace and is precisely the sort of competition that promotes the consumer interests that the Sherman Act aims to foster."); *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) ("It is competition, not competitors, which the [Sherman] Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses.").

79. See *United States v. Colgate & Co.*, 250 U.S. 300 (1919); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

80. See *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922); *Frey & Son, Inc. v. Cudahy Packing Co.*, 256 U.S. 208 (1921).

trade.⁸¹ With the emergence of a more analytical economic approach, the Court struggled to evaluate vertical restraints on the basis of their economic efficiency.⁸² Presently, the Court seems to be entering a new era in which it looks toward possible elimination of antitrust regulation of vertical arrangements,⁸³ a perspective that comports with many of the values of the Chicago School.⁸⁴

The Supreme Court's analysis in its first two cases on vertical restraints, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*⁸⁵ (decided in 1911) and *United States v. Colgate & Co.*⁸⁶ (decided in 1919) was in keeping with its laissez-faire approach to commercial conduct.⁸⁷ The effect, however, was to put forth two opinions that, with respect to antitrust vertical restraint law, were in seeming conflict. As a result of this discord, *Dr. Miles* and *Colgate* have provided the underpinnings for the Court's vacillations between two extremes as its judicial philosophy has changed over the course of the last seventy years.

In *Dr. Miles* the Court ruled, on the basis of property doctrines prohibiting restraints on alienation, that manufacturers could not contract with distributors to set the resale price of the manufacturer's goods to customers.⁸⁸ The Court held that once the goods' title passed from manufacturer to distributor, the manufacturer could not exercise control over any contract between the distributor and its customers.⁸⁹ An exception to the property rule only could

81. See *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944).

82. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984).

83. See *ARCO v. USA Petroleum Co.*, 110 S. Ct. 1884 (1990); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988).

84. See *supra* note 28 and accompanying text.

85. 220 U.S. 373 (1911).

86. 250 U.S. 300 (1919).

87. See James May, *Antitrust in the Formative Era: Political and Economic Theory in Constitutional and Antitrust Analysis, 1880-1918*, 50 OHIO ST. L.J. 257 (1989), for an excellent historical examination of the influence of laissez-faire economic theory on the development of antitrust jurisprudence. Professor May argues that "once in America there was a powerful, widely shared vision of a natural, rights-based political and economic order that simultaneously tended to ensure opportunity, efficiency, prosperity, justice, harmony, and freedom; and laissez-faire constitutionalism and antitrust law were deemed to be crucial, complementary vehicles for its realization." *Id.* at 391.

88. *Dr. Miles*, 220 U.S. at 404. Black's Law Dictionary defines restraint on alienation as follows: "A provision in an instrument of conveyance which prohibits the grantee from selling or transferring the property which is the subject of the conveyance. Many such restraints are unenforceable as against public policy . . ." BLACK'S LAW DICTIONARY 1181 (5th ed. 1979). Contracts used by *Dr. Miles* placed a restraint on alienation by prohibiting the object conveyed from being sold below a specified price.

89. *Dr. Miles*, 220 U.S. at 399-400. The case actually involved two types of contracts, one for wholesalers and one for retailers. The Court found no problem with *Dr. Miles*' contract setting resale prices for wholesalers, because those contracts retained the wholesalers as agents for *Dr. Miles*. *Id.* at 398. The implication was that no antitrust violation existed when selling prices of agents were dictated by the manufacturer. This

be created if it was in the public interest.⁹⁰ Because resale price agreements obviously restrained trade,⁹¹ antitrust law would not permit such an exception. The *Dr. Miles* decision came to be recognized as establishing a per se rule against resale price agreements between manufacturer and distributor.⁹²

Eight years later, in apparent contrast to its earlier decision, the Court in *Colgate* ruled that a manufacturer has the right to terminate a dealer for any reason, including the dealer's refusal to charge its customers the price that the manufacturer wants it to charge.⁹³ Although *Dr. Miles* and *Colgate* appear to be in tension, they can be seen as being consistent with the Court's overarching concern for fostering laissez-faire values.⁹⁴ *Dr. Miles*, in preventing restraints on alienation, assured retailers the freedom to contract with customers as they saw fit, and *Colgate*, by permitting manufacturer termination of dealers for any reason, including disagreements over retail price, protected the manufacturers' right to do business with whomever they wished.

Even though *Dr. Miles* and *Colgate* were not inconsistent with each other with respect to laissez-faire doctrines, the two cases created considerable confusion in the lower courts with regard to antitrust issues.⁹⁵ In *United States v. A. Schrader's Son, Inc.*,⁹⁶ the Court made it quite clear, however, that it saw no inherent contradiction:

It seems unnecessary to dwell upon the obvious difference between the situation presented when a manufacturer merely indicates his wishes concerning prices and declines further dealings with all who fail to observe them, and one where he enters agreements . . . with all customers throughout the different states which undertake to bind them to observe fixed resale prices [T]he parties are combined through agreements designed to take away dealers' control of their own affairs and thereby destroy competition and restrain the free and natural flow of trade amongst the states.⁹⁷

Although the Court did not articulate specific guidelines for determining what particular activities or contexts would fall within either *Colgate* or *Dr. Miles*, the language the Court used indicated that it was concerned largely with the degree of pervasiveness of the

interpretation was confirmed in *United States v. General Electric Co.*, 272 U.S. 476, 485-87 (1926). But in 1964, in *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964), the Court decided that even consignments should come under antitrust scrutiny. *Id.* at 16.

90. *Dr. Miles*, 220 U.S. at 406.

91. *Id.* at 400.

92. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960) (stating that under *Dr. Miles*, "there is an unlawful combination where a manufacturer enters into agreements . . . which undertake to bind them to observe fixed resale prices" (quoting *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85, 99 (1920))).

93. 250 U.S. 300, 307 (1919).

94. See *supra* note 79 and accompanying text.

95. See, e.g., *United States v. A. Schrader's Son, Inc.*, 264 F. 175 (1919) (interpreting *Colgate* as overruling *Dr. Miles*), *rev'd*, 252 U.S. 85 (1920).

96. 252 U.S. 85 (1920).

97. *Id.* at 99-100.

agreements' restrictions. In other words, the focus was on the extent to which trade was restrained. The Court's first opportunity to evaluate specific conduct occurred the next year in *Frey & Son, Inc. v. Cudahy Packing Co.*⁹⁸ In *Frey* the Court held that a defendant's repeated communication of its price list to distributors as a price floor, and the distributors' subsequent "cooperation" did not fall within *Dr. Miles*' parameters and therefore were not, without more, a violation of the Sherman Act.⁹⁹ In this period of vertical restraints anti-trust law (in contrast with the later Modern Populist era),¹⁰⁰ communication and acquiescence alone did not constitute an illegal agreement.¹⁰¹ Rather, the Court examined the totality of the circumstances and the overall competition to determine the existence of a violation.¹⁰²

FTC v. Beech-Nut Packing Co.,¹⁰³ a 1922 case, is further evidence of the Court's primary concern at that time for the ultimate market impact. In *Beech-Nut*, the Court decided that the encompassing effect of certain activities on the manufacturer's part rendered them beyond permissible behavior under *Colgate* and thus were sufficient to constitute a combination to suppress price competition.¹⁰⁴ Beech-Nut, a nationwide company, instituted an elaborate system to detect and cut off price-cutters.¹⁰⁵ The Court found that even though "the merchandising conduct of the company d[id] not constitute a contract or contracts whereby resale prices are fixed, maintained, or enforced,"¹⁰⁶ the company's conduct did "show suppression of the freedom of competition by methods . . . which . . . secure[] the cooperation of its distributors and customers, which are quite as effectual as agreements express or implied intended to accomplish the same purpose."¹⁰⁷ The Court noted that through these cooperative activities Beech-Nut was able to "prevent[] all who do not sell at resale

98. 256 U.S. 208 (1921).

99. *Id.* at 210-11.

100. See *infra* notes 110-27 and accompanying text.

101. Although the Court, during the Modern Populist era, ultimately concluded that communication and acquiescence alone could constitute an agreement, see *infra* text accompanying note 125, the Court, in *Monsanto Corp. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), reversed that conclusion, *id.* at 762-64, thereby in effect resurrecting the *Frey* standard, see *infra* text accompanying notes 166-67.

102. See *Monsanto*, 465 U.S. at 762-64.

103. 257 U.S. 441 (1922).

104. *Id.* at 454-55.

105. Beech-Nut employed special agents and used special markings on its products to track down discounting dealers. *Id.* at 448-49. Wholesalers, distributors, and customers also assisted by reporting price-cutters to the company. *Id.* at 449. Beech-Nut in turn maintained and distributed a list of price-cutters and those who sold to them so that middlemen could cut off the discounter's supply of the goods. *Id.* at 450. Upon receipt of promises to abandon disapproved practices, Beech-Nut would reinstate those dealers who had been cut off. *Id.* at 450-51.

106. *Id.* at 455.

107. *Id.*

prices fixed by it from obtaining its goods.”¹⁰⁸ As a result, the Court concluded that the activities violated the Sherman Act.¹⁰⁹

As the Modern Populist School gained influence during the Depression years, the Court took an increasingly conspiratorial view of business conduct; it began to focus more on whether the defendant’s activities constituted an agreement for antitrust purposes and less on the conduct’s overall impact on trade.¹¹⁰ Over time, less extreme cooperative and interactive behavior between manufacturers and distributors became a sufficient evidentiary basis for finding an agreement in restraint of trade. In *United States v. Bausch & Lomb Optical Co.*,¹¹¹ a 1944 case, the company merely refused to deal with wholesalers who continued to do business with retailers not adhering to the resale price list.¹¹² The Court found an unlawful combination because the result of the company’s policy was that many wholesalers did refuse to sell to offending retailers.¹¹³ By 1960, even when similar policies proved unsuccessful and were abandoned, the Court, in *United States v. Parke, Davis & Co.*,¹¹⁴ still found an agreement to fix prices.¹¹⁵ Thus, the Court found combinations in restraint of trade even when price-discounting and competition were not in fact suppressed.

The caselaw over the dozen years from *Bausch & Lomb* to *Parke, Davis* demonstrates that it became increasingly difficult for a manufacturer to establish that its actions to maintain prices were of an independent nature and thus protected by *Colgate*. Although mere acquiescence by dealers to manufacturers’ price lists was not by itself sufficient to show an agreement, ultimately, any further action by either party could be construed as an illegal combination. As the *Parke, Davis* Court noted, “an unlawful combination is not just . . . a price maintenance agreement, express or implied; such a combination is also organized if the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy.”¹¹⁶

Parke, Davis was not the Modern Populist School’s last effort to sharpen the focus on agreements. What many had considered the

108. *Id.*

109. *Id.*

110. The marked change in the Court’s approach during this period is not at all surprising given the number of new Court appointments (eight between 1937 and 1942, though one, Justice Burns, retired after one year), and the general suspicion of private enterprise combined with the perceived need for government regulation and intervention generated by the Depression experience.

111. 321 U.S. 707 (1944).

112. *Id.* at 722.

113. *Id.* at 723.

114. 362 U.S. 29 (1960).

115. The manufacturer initially induced its wholesalers to cut off offending retailers. When price-discounting persisted, the manufacturer, after trying other equally unsuccessful tactics, abandoned its efforts to maintain prices, resumed supplying all the distributors’ needs, and no longer requested that wholesalers stop supplying discounters. *Id.* at 36.

116. *Id.* at 43.

effective demise of the *Colgate* doctrine¹¹⁷ occurred in *Albrecht v. Herald Co.*,¹¹⁸ decided in 1968. In that case a newspaper carrier charged a price above the maximum set by the newspaper. Unlike the defendants in *Beech-Nut* and *Bausch & Lomb*, however, the newspaper did not seek to maintain prices through the cooperation of distributors to cut off supplies to the offending retailer. To the contrary, the carrier received all the newspapers he needed. Instead, the company went outside the vertical distribution chain between it and the carrier in order to service directly the overcharged customers desiring the lower price.¹¹⁹ The newspaper's behavior easily could be construed as independent action to serve its customers, conduct that ostensibly was permitted by *Colgate*.¹²⁰

The Court, however, found that the defendant's competition with the carrier—hiring an independent subscription solicitor and turning the solicited customers over to another carrier—constituted an agreement between the defendant, the hired solicitor, and the other carrier for purposes of a Sherman Act vertical price-fixing violation.¹²¹ The *Albrecht* Court's reasoning that such conduct constituted an agreement was clearly in tension with the *Colgate* holding. *Colgate* permitted manufacturers to terminate distributors for any reason, including the refusal to charge manufacturers' list prices.¹²² *Albrecht*, however, found that a manufacturer's offers of cheaper

117. See Pitofsky & Dam, *Is the Colgate Doctrine Dead?*, 37 ANTITRUST L.J. 772, 772 (1968) (asserting that the *Colgate* Doctrine is dead because it "has been criticized by a generation of the best lawyers and scholars in the country," and it is in conflict with other opinions, thereby making the decision no longer reliable as a statement of the law); William M. Isaac, Comment, *Unilateral Refusals to Deal: King Colgate is Dead!*, 30 OHIO ST. L.J. 537 (1969) (tracing the history of *Colgate* and showing its erosion over the years starting with *A. Schrader's Son, Inc.* and continuing until *Albrecht* and predicting, thus far erroneously, that a case following *Albrecht* would overrule *Colgate*).

118. 390 U.S. 145 (1968).

119. *Id.* at 147-48.

120. See *supra* notes 93-94 and accompanying text.

121. *Albrecht*, 390 U.S. at 150. In *Albrecht* the defendant newspaper was displeased with the plaintiff independent carrier because he charged home-delivery customers a price higher than the newspaper's suggested retail price. *Id.* at 147. All carrier routes were subject to termination if their charges exceeded the advertised price. *Id.* After repeated warnings to the carrier, the newspaper exercised its contractual right to compete by hiring a subscription solicitor and successfully wooing twenty-five percent of the customers away from the offending plaintiff. *Id.* The newspaper, however, still sold the plaintiff enough newspapers for his remaining route. *Id.* The defendant turned the solicited customers over to another carrier with the understanding that they would be returned to plaintiff if plaintiff gave up his overcharging practice. *Id.* at 147-48.

It is interesting to note that *Albrecht* represents the first time the Court formally considered whether the setting of maximum prices in the vertical context came under the per se illegal rule. *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951), may have been about vertical price-maximums, but the Court chose to treat it as a horizontal agreement between two subsidiaries of a parent organization. *Id.* at 215.

122. See *supra* notes 93-94 and accompanying text.

services through another carrier to the offending retailer's customers constituted an agreement for the purposes of the statute.¹²³ Thus, although *Colgate* gave manufacturers the right to terminate dealers, *Albrecht* said that if the manufacturer tried to keep its customers in such a situation by using a third party, the manufacturer's entire course of conduct would constitute an illegal combination for the purpose of fixing prices. *Albrecht's* ruling, therefore, effectively made it impossible for a manufacturer to terminate a dealer unless the manufacturer was willing to forgo its customers.¹²⁴

Furthermore, in a footnote, the *Albrecht* Court indicated that an illegal combination could be found from the plaintiff's acquiescence to defendant's price alone or, in the alternative, from the other couriers' concurrence with the defendant's price list.¹²⁵ In other words, though under *Colgate* the defendant has the right to terminate those dealers who do not abide by the list price, under *Albrecht* the defendant can be found guilty of per se vertical price-fixing if any of the dealers do charge the price list.¹²⁶ In effect, after *Albrecht*, mere acquiescence was no longer a safe harbor and the *Colgate* doctrine seemed dead.¹²⁷

123. *Albrecht*, 390 U.S. at 150.

124. The question still left open is whether it would have been permissible for the newspaper to serve its customers directly through its employees rather than through independent contractors. If such direct service is permissible, there is an incentive for the newspaper to integrate forward vertically, that is, make its couriers its employees in order to control price without being subject to antitrust scrutiny. This result certainly would not please the Modern Populist School analysts. See, e.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379-81 (1967) (discussing an aversion to exactly that kind of integration).

125. *Albrecht*, 390 U.S. at 150 n.6.

126. *Id.*

127. Even as recently as 1983, the validity of the *Colgate* doctrine after *Albrecht* was unclear. The Eighth Circuit's opinion in *Russell Stover Candies, Inc. v. FTC*, 718 F.2d 256 (8th Cir. 1983), reflects that uncertainty. The conduct at issue was exactly the kind that *Colgate* originally was intended to protect against. Stover announced to every prospective retailer its policy of refusing to sell to those retailers who would sell its products at less than its suggested minimum price. *Id.* at 257. It communicated these resale prices through price lists, invoices, order forms, and pre-ticketing on all of its products. *Id.* Stover neither requested nor accepted any assurances from either prospective or existing dealers to adhere to resale prices. *Id.* It had, however, terminated some dealers that had sold below the listed price. *Id.* Stover was charged by the FTC with unlawfully contracting and combining with dealers to fix resale prices. See *id.* The basis for the charge was the designated price list and the announced policy of termination in cases of lower prices. See *id.* The administrative law judge dismissed the case because it found that Russell Stover fit "within all corners" of the *Colgate* doctrine. See *id.* The FTC reversed the administrative law judge's conclusion, finding that for statutory purposes, an agreement could be found in Stover's combination with those dealers who "unwillingly complied," and that *Colgate* only protected Stover's initial right to select retailers, but did not protect any right to base continued dealings on the retailer's pricing policy. See *id.* at 258. Given *Albrecht*, the FTC's position was hardly unreasonable.

Upon reviewing the arguments, the court of appeals reversed the FTC's finding and concluded that the case was in fact governed by *Colgate*. *Id.* at 260. The Eighth Circuit acknowledged that the Supreme Court may have intended to declare the *Colgate* doctrine dead, and that, in particular, footnote six of the *Albrecht* opinion certainly foreshadowed such a result, but agreed with the administrative law judge's finding that the facts in *Stover* were clearly within the traditional understanding of what the *Colgate* doctrine preserved. *Id.* at 259-60. In the panel's view, if the Supreme Court intended to overrule *Colgate*, it was up to that tribunal to do so. *Id.* at 260.

Thus, during the years that the Modern Populist philosophy dominated judicial antitrust thinking, the Supreme Court moved as far as it could to erode all possible meaning from the *Colgate* doctrine, which protected a manufacturer's right, if acting independently, to terminate a dealer over displeasure with the dealer's prices. And so it remained until 1984, when the Supreme Court, upon reviewing the Seventh Circuit's decision in *Spray-Rite Service Corp. v. Monsanto Co.*,¹²⁸ shifted direction once more. Not only did the Supreme Court resurrect the *Colgate* doctrine, but it gave it teeth by creating a new standard for establishing vertical price-fixing, one that would be extremely difficult for a plaintiff to meet. Whereas prior to *Monsanto* every effort was made by the Court to impute a price-fixing agreement when a manufacturer terminated a price-cutting dealer, after *Monsanto* the Court required the plaintiff to present evidence that would exclude the possibility that the manufacturer had acted independently.¹²⁹ The *Monsanto* Court's turnaround reflected the erosion of Modern Populist influences as they gave way to the emergence of efficiency analysis as the basis for antitrust decisions.

III. Vertical Nonprice Restraints: The Economic Analysis of Interbrand Versus Intrabrand Competition

The newly announced standard in *Monsanto Co. v. Spray-Rite Service Corp.*,¹³⁰ did not arise in a vacuum. It was the result of a separate line of cases regarding the antitrust treatment of vertical nonprice restraints, which already had shifted from the Modern Populist framework to the economic efficiency approach. The first time the Supreme Court dealt with vertical nonprice restraints directly and as conduct distinct from price restraints was in 1963 in *White Motor Co. v. United States*.¹³¹ That case involved resale price maintenance, but it also implicated the manufacturer's restrictions on its dealers' territory and customer base.¹³² The government, taking a Modern Populist perspective, argued that these restrictions, along with the resale price maintenance agreements, were per se violations of the Sherman Act.¹³³ White Motor asserted that the territorial restrictions in fact had strong procompetitive effects, allowing the dealers to focus on competing with other manufacturers rather than dissipating their energies competing with each other and that outlawing territorial restrictions actually would reduce competition. White Motor further argued that the customer restrictions were necessary

128. 684 F.2d 1226 (7th Cir. 1982), *aff'd*, 465 U.S. 752 (1984).

129. 465 U.S. 752, 764 (1984).

130. 465 U.S. 752 (1984); see *supra* text accompanying notes 128-29.

131. 372 U.S. 253 (1963).

132. *Id.* at 261.

133. *Id.* at 256.

for it to compete effectively with respect to price for certain high volume customers and therefore were not unreasonable restraints of trade in violation of antitrust laws.¹³⁴

Justice William O. Douglas, writing for the Court, took a position at variance with his usual views on corporate conduct.¹³⁵ Noting that this was the first case of territorial and customer restrictions in vertical arrangements the Supreme Court had addressed,¹³⁶ Justice Douglas acknowledged the possibility that such nonprice restraints might have strong procompetitive effects.¹³⁷ He asserted, however, that the Court knew too little about customer and territorial restrictions¹³⁸ and, that based on the "bare bones" of facts before it, was unable to reach a judgment without trial as to whether such restrictions should be treated as per se violations or analyzed under the rule of reason.¹³⁹ Thus, although the Court did "not intimate any view of the merits"¹⁴⁰ and remanded the case for a full hearing,¹⁴¹ *White Motor* represents the first time that the Court explicitly entertained modern efficiency arguments to assist its decisionmaking in the vertical restraints area. *White Motor*, therefore, set the stage for a possible future ruling that nonprice restraints could be subject to rule of reason analysis that also would include modern efficiency considerations.

The next time the Court addressed vertical nonprice restraints, however, in *United States v. Arnold, Schwinn & Co.*,¹⁴² it instead applied the Modern Populist standard of per se illegality.¹⁴³ The dissent objected, arguing for the application of economic efficiency considerations under the rule of reason.¹⁴⁴ Writing for the majority, Justice Abe Fortas rejected the dissent's reasoning, asserting that nonprice restraints "are so obviously destructive of competition that their mere existence is enough" to constitute a per se violation of the Sherman Act.¹⁴⁵ Thus, the majority, at that time, did not accept the *White Motor* economic efficiency conjecture that a rule of

134. *Id.* at 257-59.

135. *See supra* note 9.

136. *White Motor*, 372 U.S. at 261.

137. *Id.*

138. *Id.* The case reached the Court on an appeal from summary judgment in favor of the government.

139. *Id.*

140. *Id.* at 264.

141. *Id.*

142. 388 U.S. 365 (1967).

143. *Id.* at 375-76.

144. *Id.* at 388 (Stewart, J., concurring in part and dissenting in part). The only change in the Court's membership in the interim was that Justice Fortas replaced Justice Arthur Goldberg, a change that would not explain the Court's change in attitude between *White Motor* and *Schwinn*. Justices Brennan and Douglas changed their positions, joining Justice Fortas and two of the dissenters in *White Motor* to declare vertical nonprice restraints per se illegal. The third dissenter in *White Motor*, Justice Clark, took no part in the *Schwinn* decision but presumably would have joined the majority. The majority distinguished facts in *Schwinn* on the rather dubious basis that *Schwinn* was a healthy, successful company, rendering its conduct per se illegal. *Id.* at 374.

145. *Id.* at 379. In *Schwinn* the Court examined vertical nonprice restraints on customers and territories after a full trial below. Based on that record, Justice Fortas' majority opinion distinguished between nonprice restraints when title had passed to the

reason analysis might be more appropriate for vertical nonprice restraints in general.¹⁴⁶

Reflecting both changes in the composition of the Court¹⁴⁷ and changes in societal and political acceptance of the use of economic reasoning to judge business activity, the Court in 1977 overruled *Schwinn's* application of the per se rule. In *Continental T.V., Inc. v. GTE Sylvania Inc.*,¹⁴⁸ the Court held that all vertical nonprice restraints were now subject to the rule of reason.¹⁴⁹ The *Sylvania* Court, admonishing the *Schwinn* Court for not adhering to established precedents for limiting the use of per se rules,¹⁵⁰ engaged in fairly extensive and sophisticated economic analysis.¹⁵¹ For the first

distributors and when it had not. *Id.* at 378-79. In the former instances, nonprice restraints were deemed per se illegal, whereas the latter were to be subject to the rule of reason. *Id.* at 379-80.

As in *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U.S. 373 (1911), the Court's reasoning in *Schwinn* was based on the rules of property law prohibiting restraints on alienation. 388 U.S. at 380. In addition, the Court noted that most distributions of merchandise were based on sales and not consignment, and that permitting restraints on alienation of goods would broadly suppress competition. *Id.* at 379-80. The property doctrines were not at issue in those cases when title had not passed. On grounds consistent with the Modern Populist view, the Court concluded that a more flexible approach was appropriate. *Id.* at 380. Justice Fortas asserted that a per se rule in such a context could hamper the ability of smaller enterprises to compete with corporate giants and might lead to increased vertical integration at the distribution levels, a result contrary to the Modern Populist ideal. *Id.*

Although *Dr. Miles'* vertical price restraint doctrine held that there was no Sherman Act violation when title had not passed, *see supra* notes 88-92 and accompanying text, the Court in *Simpson v. Union Oil*, 377 U.S. 13 (1964), decided that rule of reason analysis should be applied to determine whether the lack of title transfer was a sham to cover-up illegal vertical price-fixing, *id.* at 18. Thus, *Schwinn's* treatment of nonprice restraints exactly paralleled the then-current law on price restraints.

146. *See supra* notes 135-41 and accompanying text.

147. Of the Justices voting in the majority for per se illegality in *Schwinn*, only Justice Brennan remained on the Court when *Sylvania* was decided. Justice Brennan dissented in *Sylvania*, joined by Justice Thurgood Marshall, who had replaced Justice Clark. Although Justice Clark, a member of the Courts deciding both *Schwinn* and *White Motor* had not taken part in *Schwinn*, his dissent in *White Motor* advocating per se illegality for nonprice restraints indicates that he would have voted the same way as Justice Marshall did in *Sylvania*. The other members of the *Schwinn* majority, Chief Justice Warren, along with Justices Fortas, Black, and Douglas, had been replaced by Chief Justice Burger, and Justices Blackmun, Powell, and Stevens, respectively. Justice Stewart, a dissenter in *Schwinn*, joined the newcomers to form the majority in *Sylvania*. Justice White, the only other Justice besides Justices Brennan and Stewart on the Court for both cases, took no part in *Schwinn* and concurred in the judgment in *Sylvania*.

148. 433 U.S. 36, 59 (1977). *Schwinn* and *Sylvania* vividly illustrate the differences between the Warren Court's Modern Populist view of antitrust and the Burger Court's more moderate approach. *Sylvania's* overruling of *Schwinn* is one of the rare instances in antitrust law that the Court has overruled explicitly a relatively recent decision.

149. *Id.* at 58-59.

150. *Id.* at 51. The *Sylvania* Court quoted the standard for per se illegality set forth in *Northern Pacific Railway v. United States*, 356 U.S. 1 (1958), which condemns activities per se if "their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable . . . without elaborate inquiry." *Sylvania*, 433 U.S. at 50 (quoting *Northern Pac. Ry.*, 356 U.S. at 5).

151. 433 U.S. at 51-52 & n.19.

time, the Supreme Court accepted the economic distinction between interbrand and intrabrand competition, the former referring to competition between different manufacturers of competing goods and the latter referring to competition among dealers for the sale of one manufacturer's goods.¹⁵² The *Sylvania* Court criticized the *Schwinn* opinion for focusing primarily on the restraints' impact on intrabrand competition without examining their effects on interbrand competition.¹⁵³ Justice Lewis Powell, writing for the majority, concluded that even though vertical nonprice restraints may restrict intrabrand competition, they also often promote interbrand competition "by allowing the manufacturer to achieve certain efficiencies in the distribution of his product."¹⁵⁴ He suggested that the manufacturer's interest in enhancing interbrand competition would curtail any anticompetitive effect that the restraints could have on intrabrand competition.¹⁵⁵ Furthermore, he noted, the manufacturer's efforts to engage in interbrand competition corresponded to the public interest,¹⁵⁶ and the enhancement of interbrand competition was the primary goal of antitrust law.¹⁵⁷ Thus, nonprice restraints have to be examined under the rule of reason to determine whether they are, in fact, in furtherance of interbrand competition. The Court's reasoning in *Sylvania* reflects a wholesale adoption of the modern economic efficiency approach.¹⁵⁸

IV. Monsanto and the Free Rider Problem

Deciding that some vertical restraints could have a predominately procompetitive effect, and placing nonprice restraints into the rule

152. *Id.* at 52 n.19.

153. *Id.* at 51-52.

154. *Id.* at 54.

155. *Id.* at 54-55.

156. *Id.* at 56 n.24. Justice Powell acknowledged that this finding is controversial. *Id.* at 56.

157. *Id.* at 52 n.19.

158. Because antitrust law is concerned with regulating markets, antitrust decisions always have applied some form of economic reasoning. There also are cases throughout antitrust history in which the Court's economic analysis would stand up against modern economic efficiency and market analysis. See, e.g., *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918). But there is a considerable distinction between the modern efficiency and market analysis and the economic analysis of industrial concentration that was so popular from the 1940s to the 1970s. The latter, more formally known as structural analysis, applied economic statistics to measure degrees of concentration and profit rates. Structuralists' antitrust conclusions, however, determined whether the statistics indicated an industrial structure that deviated from the atomistic paradigm of the Modern Populist School. There was little room for consideration of whether the deviations might be due to positive efficiency results, such as economies of scale, or innovative technology or organization. Nor was there much analysis of whether the market was subject to competitive forces in spite of high levels of concentration and barriers to new entry. Efficiency and competitive market analysis has been developed relatively recently, and the Chicago School has had a major influence on its growth. It is this more sophisticated and subtle reasoning that this Article refers to as modern efficiency and market analysis. For a more detailed discussion of the debate surrounding the *Sylvania* decision, see Kurt A. Strasser, *Vertical Territorial Restraints After Sylvania: A Policy Analysis and Proposed New Rule*, 1977 DUKE L.J. 775.

of reason category,¹⁵⁹ the Court opened the door to a legal imbroglio. Although as the Court noted in *Continental T.V., Inc. v. GTE Sylvania Inc.*,¹⁶⁰ the manufacturer may be imposing these restraints on retailers to enhance its competitive position relative to other manufacturers,¹⁶¹ typically the vertical nonprice restraints are costly to the retailer. When the restraints require the retailer to provide services beyond the mere selling of goods, a retailer may attempt to avoid restraint-related costs by not providing those services. In some circumstances, such a retailer can become a free rider,¹⁶² a phenomenon that has been the focus of much attention since the *Sylvania* decision.¹⁶³

A classic example of free riding occurs when full service retailers, in response to manufacturers' efforts to increase sales, incur the costs of training personnel to assist customers in determining their product needs. A free riding retailer avoids these costs by forgoing sales experts, which permits it to discount the product's price while still maintaining reasonable profits. If a free rider is in the vicinity, the customer can go to the full service store to derive the benefits of the expert personnel but then purchase the product from the discounter; the discounter thus takes a "free ride" at the expense of the full service store. Because of the latter's forgone sales, the probability of recouping expenses incurred in providing the trained personnel is reduced. As a result, the full service store loses the incentive to provide those services that the manufacturer views as beneficial to its overall sales level. In such instances, the manufacturer may wish to terminate the free-riding dealer.

The judicial difficulties the free rider issue creates arise when a terminated discounting dealer files an antitrust action against the manufacturer. The question facing the trier of fact is whether the dealer was terminated because of its price discounting activities or because of its failure to adhere to nonprice requirements. If the former is true and an agreement can be found (say, between the manufacturer and other dealers), then the manufacturer's action is per se illegal.¹⁶⁴ If the latter is the case, then the manufacturer's restraints are to be judged under the rule of reason.¹⁶⁵ Because almost all restraints have a price impact, and the distinction between price and nonprice is often more apparent than real, the *Sylvania* holding alone was not sufficient to ensure that vertical nonprice restraints would be judged under the rule of reason. *Monsanto Co. v. Spray-Rite*

159. See *supra* notes 148-58 and accompanying text.

160. 433 U.S. 36 (1977).

161. *Id.* at 54.

162. See *supra* text accompanying notes 61-68.

163. See *supra* note 61 and accompanying text.

164. See *supra* notes 110-15 and accompanying text.

165. See *supra* notes 148-58 and accompanying text.

Service Corp.,¹⁶⁶ decided in 1984, focused precisely on that concern:

[I]t is of considerable importance that independent action by the manufacturer, and concerted action on nonprice restrictions, be distinguished from price-fixing agreements, since under present law the latter are subject to per se treatment. . . . If an inference of such an agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded.¹⁶⁷

Monsanto attempted to avoid the erosion of *Sylvania* and *United States v. Colgate & Co.*¹⁶⁸ by weakening the standards set out in *Albrecht v. Herald Co.*¹⁶⁹ for showing a price-fixing conspiracy.¹⁷⁰ It did so by requiring the plaintiff to prove that the manufacturer's actions could not have been independent.¹⁷¹

In *Monsanto* the manufacturer terminated a price discounter following complaints by other dealers.¹⁷² The question before the Court was whether those facts were sufficient to establish a vertical price-fixing conspiracy.¹⁷³ Justice Powell, writing for the majority, said no: "Permitting an agreement to be inferred merely from the existence of complaints, or even from the fact that termination came about 'in response to' complaints, could deter or penalize perfectly legitimate conduct."¹⁷⁴ The Court then established a new evidentiary standard, one requiring that plaintiffs' evidence "tend[] to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."¹⁷⁵ The Court required the plaintiff to establish that "the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.'"¹⁷⁶

The *Monsanto* Court did not abandon the per se rule for vertical price-fixing agreements entirely; it merely made finding them more difficult. Because other evidence in *Monsanto* established the existence of an agreement to maintain prices and to terminate the discounter for its pricing activities, the Court concluded that the

166. 465 U.S. 752 (1984).

167. *Id.* at 763.

168. 250 U.S. 300 (1919); see *supra* note 93 and accompanying text.

169. 390 U.S. 145 (1968); see *supra* notes 118-27 and accompanying text.

170. "On a claim of concerted price fixing, the antitrust plaintiff must present evidence sufficient to carry its burden of proving that there was such an agreement." 465 U.S. at 763.

171. *Id.* at 768.

172. *Id.* at 758-59.

173. *Id.* at 759. As long as the case involves a manufacturer imposing a price on a dealer, the Court does not seem to distinguish between whether the initiative to impose a price originated with the manufacturer or other dealers. But see *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 736 (1988) (Stevens, J., dissenting) (arguing that when a manufacturer is responding to other dealers' complaints, the legality of its actions should be judged under horizontal price-fixing standards). The requirements for inferring illegal horizontal price-fixing agreements are not as strict as those for vertical price-fixing agreements. See, e.g., *id.* at 734.

174. *Monsanto*, 465 U.S. at 763.

175. *Id.* at 764.

176. *Id.* (quoting *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 111 (3d Cir. 1980), cert. denied, 451 U.S. 911 (1981)).

manufacturer's termination was in fact per se illegal.¹⁷⁷ Resisting arguments by both antitrust scholars and the Solicitor General¹⁷⁸ to move vertical price-fixing wholesale into the rule of reason category, the *Monsanto* Court chose to keep alive the rule of per se illegality for that activity.

Thus, although upholding per se illegal treatment for vertical price-fixing, the *Monsanto* Court also articulated a stricter standard for proving such conduct: the evidence must tend to exclude the possibility of independent action.¹⁷⁹ The *Monsanto* Court wanted to reduce the number of cases that would be considered per se illegal, but what would occur in those cases escaping per se illegal treatment is not clear. This determination hinges on whether the Court intended its new standard for establishing an agreement to apply to vertical restraints in general, or to vertical price restraints alone.

One interpretation is that the new standard applied only to vertical price agreements. If the *Monsanto* Court's rule was meant to apply only to price-fixing agreements, and some other lower standard would be sufficient to show a nonprice agreement, then a plaintiff's failure to prove a price-fixing conspiracy would not preclude the defendant's conduct from being analyzed under the rule of reason as a nonprice restraint. Under this interpretation, *Monsanto* expands the scope of the rule of reason by narrowing the reach of per se illegal categorization, a view consistent with most scholars' understanding of the case.¹⁸⁰

An alternative interpretation is that the Court intended the new stringent standard to apply equally to price and nonprice restraints. If this interpretation is accurate, any conduct that fails to meet the standard for price-fixing agreements necessarily would fail to meet the standard for nonprice restraints. As a result, large numbers of vertical agreements would be neither per se illegal nor subject to the rule of reason. Although consistent with the goal of relieving manufacturers of excessive antitrust concerns about their vertical restraints, such an effect appears to be in tension with the Court's

177. *Id.* at 768.

178. *See id.* at 761 n.7.

179. *Id.* at 751.

180. *See, e.g.,* Edward D. Cavanagh, *Attorney's Fees in Antitrust Litigation: Making the System Fairer*, 57 *FORDHAM L. REVIEW* 51, 71 (1988) (arguing that "little room remains for per se analysis" because of the Court's efforts in *Monsanto* (as well as in *Sylvania* and *Sharp*)); George A. Hay, *Vertical Restraints After Monsanto*, 70 *CORNELL L. REV.* 418, 433 (1985) (arguing that "[t]he *Monsanto* Court sought an evidentiary standard . . . to preserve the rules of thumb inherited from prior decisions: price agreements are per se illegal [and] vertical nonprice agreements are subject to the rule of reason"); Earl E. Pollock, *Vertical Restraints and the Secularization of Antitrust*, 75 *CAL. L. REV.* 951, 953 (1987) (stating that "as *Monsanto* illustrates, it is . . . possible to give obeisance to a per se rule while cutting back sharply on its scope and bite").

expressed concern of preserving the *Sylvania* doctrine,¹⁸¹ which opts for rule of reason scrutiny of manufacturers' conduct rather than no court examination whatsoever.¹⁸²

The most likely explanation is that the *Monsanto* Court was not aware of the ambiguities in its decision, and did not intend to make an explicit policy choice regarding the extent of the application of the new standard. The first alternative,¹⁸³ however, seems more in line with the Court's expressed goal of maintaining judicial supervision over manufacturers' vertical restraints.

The *Monsanto* Court's discussion of independent action further supports the inference that the standard for finding an agreement should be stricter for price-fixing activities than for nonprice restraints. The Court intimated that nonprice activities could constitute evidence of independent action for purposes of determining whether there was a price-fixing agreement.¹⁸⁴ If a manufacturer's termination of a dealer for failing to abide by nonprice restraints constitutes independent action, then, by definition, that action will not satisfy the agreement requirement for finding an illegal price restraint. If the evidentiary standard for finding an agreement is the same for both price and nonprice restrictions, then those nonprice restraints cannot satisfy the agreement requirement in the nonprice category either, thereby making all nonprice restraints legal by definition. Clearly, this result is inconsistent with the *Monsanto* Court's expressed intent to preserve the *Sylvania* doctrine of subjecting non-price restraints to rule of reason scrutiny.¹⁸⁵

It is most likely that if the Court had reflected explicitly on these issues, it would have created a separate, lower, standard for finding an agreement for nonprice restraints to ensure rule of reason evaluation. If this is an accurate reading of the case, then *Monsanto* obviates the concern that manufacturers' legitimate nonprice activities with a price impact will be viewed by juries as a per se illegal price restraint, a concern subsequently expressed by the Court in *Business Electronics Corp. v. Sharp Electronics Corp.*¹⁸⁶ It is, therefore, questionable whether *Sharp's* additional requirements for finding a price agreement¹⁸⁷ were necessary or even appropriate.

Regardless of the precise nature of the holding, *Monsanto* reflects the emerging dominance of rule of reason efficiency analysis to evaluate antitrust concerns. Whether *Sharp* and *ARCO v. USA Petroleum Co.*¹⁸⁸ continued in that same vein is subject to question.

181. *Monsanto*, 465 U.S. at 763 (indicating that the new evidentiary standard being formulated was intended to avoid the "serious ero[sion]" of *Sylvania* and *Colgate*).

182. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977).

183. See *supra* text accompanying note 180.

184. *Monsanto*, 465 U.S. at 763.

185. *Id.*

186. 485 U.S. 717 (1988).

187. See *infra* text accompanying notes 206-12.

188. 110 S. Ct. 1884 (1990).

V. The Road to *Per Se* Legality

A. Business Electronics Corp. v. Sharp Electronics Corp.—*The Opinion*

Just as *Monsanto Co. v. Spray-Rite Service Corp.*'s¹⁸⁹ stringent evidentiary standard promoted the Court's desire in *Continental T.V., Inc. v. GTE Sylvania Inc.*¹⁹⁰ to permit manufacturers to use nonprice restraints to assure better services,¹⁹¹ the Court's opinion in *Business Electronics Co. v. Sharp Electronics Corp.*¹⁹² claimed to do the same by imposing a substantive requirement that "a vertical restraint is not illegal *per se* unless it includes some agreement on price or price levels."¹⁹³

In *Sharp*, the manufacturer had two appointed dealers in the Houston area, Business Electronics Corporation (BEC) and Hartwell. Both dealers discounted Sharp's prices, though BEC did so more consistently and more extensively. In responding to Hartwell's complaints about BEC's discounting, Sharp stated that it could not dictate BEC's prices. Hartwell then threatened to discontinue being Sharp's dealer if Sharp did not terminate BEC. Sharp subsequently terminated BEC, which then filed suit charging Sharp with *per se* illegal vertical price-fixing.¹⁹⁴ At trial, one of the judge's interrogatories to the jury stated that if the jury found an agreement or understanding between Sharp and Hartwell to terminate BEC because of the latter's price-cutting, the activity was unlawful, even if (as the judge explained) the agreement was aimed at eliminating alleged evils of price-cutting.¹⁹⁵ The jury verdict in favor of BEC was reversed and the case remanded by the Fifth Circuit, which concluded that the interrogatory and instructions were erroneous.¹⁹⁶ The Fifth Circuit held that "to render illegal *per se* a vertical agreement between a manufacturer and a dealer to terminate a second dealer, the first dealer 'must expressly or impliedly agree to set its prices at some level, though not a specific one. The distributor cannot retain complete freedom to set whatever price it chooses.'"¹⁹⁷ The United States Supreme Court, in a 6-2 split, affirmed.¹⁹⁸

189. 465 U.S. 752 (1984).

190. 433 U.S. 36 (1977).

191. For a discussion of the relationship between nonprice restraints and services, see *infra* note 314 and accompanying text.

192. 485 U.S. 717 (1988).

193. *Id.* at 735-36.

194. *Id.* at 721. BEC filed suit under § 1 of the Sherman Act. 15 U.S.C. § 1 (1988).

195. See *Sharp*, 485 U.S. at 721-22.

196. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 780 F.2d 1212, 1220 (5th Cir. 1986), *aff'd*, 485 U.S. 718 (1988).

197. *Sharp*, 485 U.S. at 722-23 (quoting *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 780 F.2d 1212, 1218 (5th Cir. 1986), *aff'd*, 485 U.S. 718 (1988)).

198. 485 U.S. 717.

Justice Scalia, writing for a majority that included Justices across the ideological spectrum,¹⁹⁹ first emphasized that, in general, the rule of reason was the approach to be used to resolve antitrust questions. Per se rules were the exceptions and were to be applied "only for 'conduct that is manifestly anticompetitive.'" ²⁰⁰ That category was limited to conduct " "that would always or almost always tend to restrict competition and decrease output." " ²⁰¹ Although the majority once again maintained, on that basis, that vertical price restraints were still per se illegal,²⁰² it also reaffirmed the conclusions in *Sylvania* and *Monsanto* that nonprice restraints did not offer the same pernicious anticompetitive threat because they had "real potential to stimulate interbrand competition."²⁰³ Because the resulting interbrand competition would adequately safeguard any intrabrand competition concerns and interbrand competition was "the primary concern of the antitrust laws,"²⁰⁴ it was critical that vertical nonprice restraints be precluded from per se illegal categorization and judged under the rule of reason.²⁰⁵

Applying these principles to the case at bar, Justice Scalia went on to declare that there had been no showing that agreements between manufacturers and dealers to terminate price cutters, without agreements as to price, almost always had the restrictive effect on competition and output that mandated per se illegal treatment.²⁰⁶ Even though one of the dangers of vertical price-fixing conduct is its potential to facilitate horizontal price-fixing, or cartelization,²⁰⁷ Justice Scalia argued that absent an agreement on price levels, a manufacturer's incentive and ability to cartelize is reduced significantly.²⁰⁸

Harkening back to the *Monsanto* Court's concern that judicial misperceptions might prevent manufacturers from protecting against free riders,²⁰⁹ Justice Scalia emphasized, once again, that in many cases in which there are nonprice restraints, there will be an effect

199. The majority was comprised of Chief Justice Rehnquist, and Justices Scalia, O'Connor, Blackmun, Marshall, and Brennan. Justice Anthony Kennedy did not participate. Justices Stevens and White dissented. In the antitrust context, Chief Justice Rehnquist and Justices Scalia and O'Connor tend to be sympathetic to a market or efficiency approach, though their sympathy is not necessarily as strong as the Chicago School's. See *supra* note 6. Justices Brennan and Marshall, on the other hand, traditionally held antitrust views consistent with the Warren Court, which represented the most sophisticated form of the Modern Populist perspective: the Structuralist approach. See *supra* note 6. Justice Blackmun does not seem to have a clearly identifiable antitrust perspective.

200. *Sharp*, 485 U.S. at 723 (quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977)).

201. *Id.* (quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 427 U.S. 284, 289-90 (1985) (quoting *BMI v. CBS*, 441 U.S. 1, 19-20 (1979))).

202. *Id.* at 724.

203. *Id.* (quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977)).

204. *Id.* at 726.

205. *Id.* at 725. For an analysis of interbrand versus intrabrand competition, see *supra* notes 130-58 and accompanying text.

206. *Sharp*, 485 U.S. at 726-27.

207. *Id.* at 725-26.

208. *Id.* at 726-27.

209. 465 U.S. 752, 763-64 (1984); see *supra* notes 162-71 and accompanying text.

on price, and that "[i]n the vast majority of cases, it will be extremely difficult for the manufacturer to convince a jury that its motivation was to ensure adequate services."²¹⁰ As a result, manufacturers would avoid engaging in efficient business strategy because of the possibility of antitrust liability.²¹¹ Finally, Justice Scalia rejected the argument that agreements as to price levels typically follow from the termination of a price-cutter and thus required a per se rule. Such a theory was "simply incompatible with the conclusion of *GTE Sylvania* and *Monsanto*" that manufacturers often are motivated by a desire to provide better services and to eliminate free riding.²¹² Therefore the Court announced a new rule for assessing vertical restrictions: without an agreement on price or price levels, the conduct was not per se illegal.

B. The Sharp Critique

Justice Scalia's concern that manufacturers would be inhibited from engaging in economically efficient nonprice restraints because of the possibility of a jury focusing only on the almost inevitable price impact of such conduct, appears ill founded in view of *Monsanto*'s already stringent standard for determining the existence of price-fixing agreements.²¹³ *Monsanto* requires that the jury find no possibility of the manufacturer acting independently in order to conclude that the defendant's conduct constituted an agreement for price-fixing purposes.²¹⁴ Because, implicitly, *Monsanto* also requires that the jury consider whether any nonprice activities can constitute such independent action,²¹⁵ it would be very difficult for juries to find price-fixing agreements when nonprice activities are involved. This conclusion is true regardless of whether the *Monsanto* Court created one standard or two.²¹⁶ If only one standard for finding an agreement applies to both price and nonprice activity, then all or almost all nonprice restraints would escape antitrust scrutiny. If two standards exist, nonprice activities necessarily would fall into the rule of reason category. In either case, nonprice activities would escape per se illegal categorization, which was the goal Justice Scalia claimed to seek.

Justice Scalia's fears of undue condemnation of manufacturers'

210. *Sharp*, 485 U.S. at 727. This is because "price cutting and some measure of service cutting usually go hand in hand." *Id.* at 727-28.

211. *Id.* at 728.

212. *Id.* at 731.

213. See *supra* text accompanying notes 162-85.

214. Some nonprice restraints in which the price restraint component predominates probably would, however, still be found to be per se illegal.

215. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984); see *supra* notes 175-76 and accompanying text.

216. See *supra* notes 180-81 and accompanying text.

vertical restrictions would be valid only if there was one standard and it was an easy standard to meet. In other words, if there was a low standard for proving the existence of a nonprice agreement *and* the jury could use that standard when deciding whether the price effects of the conduct constituted price-fixing, then much nonprice activity would be at risk of being declared illegal. This could not occur, however, because it would contradict *Monsanto's* requirement of a very high standard for showing price-fixing agreements.²¹⁷ Thus, the scenario Justice Scalia fears is not possible when a jury is instructed properly under the *Monsanto* evidentiary rule. Moreover, when the nonprice activities fail to satisfy the higher, price agreement standard, the activities automatically will fall under rule of reason scrutiny, a result Justice Scalia purportedly approves.²¹⁸

Nevertheless, Justice Scalia proceeded to erect another safeguard to prevent juries from finding per se illegal price-fixing, one that not only is unnecessary but is overreaching as well. Although Justice Scalia gave the appearance of moving a substantial part of price-fixing cases into the rule of reason category, an impression that most antitrust scholars hold,²¹⁹ closer scrutiny reveals that Justice Scalia actually may have created a de facto per se legal category for some, if not all, vertical price restraints.

That many scholars have interpreted *Sharp* as expanding the rule of reason treatment for vertical nonprice restraints while narrowing the possibility of per se illegal treatment for vertical price restraints is understandable. After all, Justice Scalia himself stated that the purpose of *Sharp* is "to resolve a conflict . . . regarding the proper dividing line between the rule that vertical price restraints are illegal *per se* and the rule that vertical nonprice restraints are to be judged under the rule of reason."²²⁰ Indeed, the entire opinion revolves around the importance of limiting per se illegal categorization and maintaining the rule of reason as the norm. Justice Scalia's language connotes that all vertical restraints fall on a continuum between pure price and pure nonprice restraints, and that the only question is where to draw the line between per se illegal treatment and rule of reason treatment for any particular restraint. Because Justice Scalia's expressed intent is to limit the extent of per se illegal categories,²²¹ it is not unreasonable to conclude that the shift in the dividing line to narrow the spectrum of per se illegal candidates automatically expands the spectrum of rule of reason candidates so as to encompass those no longer subject to per se condemnation.

This perception, however, is not accurate. Because a restraint is no longer considered a price restraint for antitrust purposes, and therefore is not per se illegal, does not mean that it can automatically be treated as a nonprice restraint to be subject to the rule of

217. See *supra* notes 175-79 and accompanying text.

218. See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988).

219. See *supra* note 75 and accompanying text.

220. *Sharp*, 485 U.S. at 720.

221. *Id.* at 716.

reason. Under Justice Scalia's new standards, it is quite possible (and the facts in *Sharp* are a good example) that a restraint's sole function is to control price and yet it will not be considered vertical price-fixing.²²² As a result, in cases where there is no nonprice component, manufacturers not only will escape per se condemnation, but also rule of reason scrutiny. In effect, Justice Scalia created a new category of per se legal price restraints that would not be subject to any antitrust scrutiny.²²³ This result is perfectly consistent with the Chicago School's view on vertical restraint regulation: that manufacturers should be allowed to conduct their business with their distributors unfettered by the prospect of antitrust chastisement.²²⁴ Furthermore, as a practical matter, manufacturers easily can modulate their conduct (by not mentioning specific price levels with their cartelizing compatriots)²²⁵ so that any price-fixing efforts automatically will fall into this implicit per se legal category. The net effect of Justice Scalia's new standard is not so much to enlarge the scope of rule of reason applications (though, to some extent, that end is achieved), but to eliminate from the continuum altogether a large class of cases involving vertical price-fixing conduct, including those that almost all scholars would agree should be subject to antitrust condemnation.

C. ARCO v. USA Petroleum Co.—*Furthering the Path*

The deregulation of vertical price restraints that the *Sharp* opinion indicates²²⁶ is continued by the Court's opinion in *ARCO v. USA Petroleum Co.*,²²⁷ particularly when read in conjunction with *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*²²⁸ The Court in *ARCO* held for the first time that a competitor cannot claim antitrust injury in those cases of vertical price-fixing that set maximum price limits, unless the competitor can demonstrate that the price-maximums were predatory in nature.²²⁹ The *ARCO* decision, in itself, created

222. See, e.g., *id.* at 739 (Stevens, J., dissenting) (demonstrating that the manufacturer did not impose nonprice restraints).

223. Because its focus was on a very clear issue of nonprice restraints, by not considering those circumstances in which no nonprice dimensions were involved, *Monsanto* also may have inadvertently created a category of per se legal vertical price restraints. At the very least, *Sharp* greatly expanded this category by allowing unambiguous vertical price restraints to enter into this category merely because they do not contain agreements as to specific price levels.

224. See *supra* note 6.

225. "If a [terminated price discounter] wishes to have a price-fixing case heard in court it must . . . prove . . . that the price fixers agreed to set a specific price. [That], I contend, is an almost impossible standard to meet. Only fools fix prices before witnesses." 137 CONG. REC. 3390 (daily ed. Oct. 15, 1991) (statement of Rep. Smith).

226. See *supra* notes 222-25 and accompanying text.

227. 110 S. Ct. 1884 (1990).

228. 475 U.S. 574 (1986).

229. *ARCO*, 110 S. Ct. at 1891-92. The requirement of predatory pricing to establish

another barrier to vertical price-fixing regulation by limiting the reach of private actions. The strength of this barrier, however, depends on the Court's definition of predatory pricing, which, in turn, depends on the interpretation of the Court's ruling, four years earlier, in *Matsushita*. Although *Matsushita* did not address vertical price-fixing issues,²³⁰ its analysis of whether a competitor suffered antitrust injury in the face of horizontal price-fixing conspiracies is precisely on point.

The *Matsushita* Court was reviewing the Third Circuit's decision reversing in part the district court's order granting summary judgment in favor of the defendant.²³¹ In reversing the Third Circuit, Justice Powell, writing for the majority, concluded that there was no genuine issue of material fact for trial on the charge of a conspiracy to engage in predatory pricing.²³² In *Matsushita*, the Court defined predatory pricing as charging prices below cost with the intent of driving one's competitors out of the market.²³³ Included in that definition was the assumption that once the competitors were driven out, the predatory firm would engage in monopoly pricing, that is, charge prices well above those that would have been established in a competitive market. The Court noted that a period of monopoly pricing was essential for the predatory firm to recoup its losses, as well as to be able to take abnormally high profits in order to make the venture worth the risk.²³⁴

The majority applied the Chicago School's economic argument that a predatory pricing strategy could not be successful because the

a plaintiff's antitrust injury usually was used in merger or monopoly cases. More recently, some court of appeals cases, such as the Ninth Circuit's opinion in *USA Petroleum Co. v. Atlantic Richfield Co. (ARCO)*, 859 F.2d 687 (9th Cir. 1988), *rev'd*, 110 S. Ct. 1884 (1990), and the Seventh Circuit's decision in *Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409 (7th Cir. 1989), started requiring evidence of predatory pricing in vertical restraint cases. The Supreme Court subsequently used *ARCO* to validate this procedure. *ARCO*, 110 S. Ct. at 1891-92. For a discussion of predatory pricing, see *infra* note 232.

230. *Matsushita* involved a suit by several American manufacturers against several Japanese manufacturers, charging the Japanese with, among other things, horizontal price-fixing in the United States and charging prices that were predatorily low, so as to unfairly drive the American manufacturers out of the American market. 475 U.S. at 577-82.

231. *Id.* at 580.

232. Some define predatory pricing broadly as "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117 (1986); see also *Fox & Sullivan*, *supra* note 10, at 206 (stating that "[a] predatory strategy is any course of conduct by a dominant firm designed to drive out, discipline or set back competitors by acts that, but for their anticompetitive impact, would not be economically sensible for the dominant firm"). There is much difference of opinion, however, on what specifically constitutes predatory behavior. For a good discussion of various definitions of predatory pricing, see *Cargill*, 479 U.S. at 117 n.12. The plaintiffs in *Matsushita*, who were competitors of the defendants, also charged them with a conspiracy to set minimum prices above the competitive levels. The Court first noted that competitors could not recover antitrust damages in those circumstances. Even though it noted that such activity was illegal as horizontal price-fixing, the effect not only caused the plaintiff-competitors no harm, but it actually benefitted them, thus precluding them from suing to recover for antitrust injury. *Matsushita*, 475 U.S. at 582-83.

233. *Matsushita*, 475 U.S. at 584 n.8.

234. *Id.* at 588-90.

defendant firms would not be able to engage in the necessary monopoly pricing.²³⁵ As soon as prices rose, competitors would enter the market, thereby driving the price back down to competitive levels. Therefore, any firm engaging in such activity was in a financially losing venture, and would either cease such efforts or be driven out of business.²³⁶ The lesson to be drawn from this analysis, the Court concluded, is that firms are too sophisticated to attempt to compete in such a foolhardy manner, and that therefore any firm engaging in price-cutting activities is unlikely to be engaging in predatory pricing.²³⁷ On this basis, the Court, in a rare move,²³⁸ granted a conditional summary judgment in favor of the defendant.²³⁹ The *Matsushita* Court did not completely close the door to the possibility of predatory pricing, but the evidentiary burden it required to establish a sufficient question of fact to go to trial, in effect, made it almost a matter of law that predatory pricing did not exist. Given the analysis in *Matsushita*, it is practically impossible, after *ARCO*, for a competitor to sue a vertical price-fixer, thereby removing one more avenue of antitrust scrutiny.

If the *Sharp* Court intended to create a category of per se legal vertical price-fixing,²⁴⁰ it can be seen as reflecting the Chicago School view that vertical restraints in general should not be subject to antitrust scrutiny.²⁴¹ One would expect that decisions guided by this principle would tend, in subsequent cases involving vertical restraints, to develop standards designed to facilitate that result. *ARCO*, therefore, can be seen, at least with regard to vertical price restraints, as another step in the direction of per se legality.²⁴²

VI. Economic Analysis

If it is true that *Business Electronics Corp. v. Sharp Electronics Corp.*²⁴³

235. *Id.* at 590-93.

236. *Id.*

237. *Id.* at 589-90.

238. See, e.g., *Poller v. Columbia Broadcasting Sys.*, 368 U.S. 464, 473 (1962) (opining that "summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot").

239. *Matsushita*, 475 U.S. at 598. The Court stated that on remand, the Third Circuit was free to consider any other evidence that might create an issue of material fact. *Id.* at 597. The standards the Court imposed for such a finding, however, were essentially impossible to meet. The Court further ruled that if no such evidence existed, summary judgment must be granted. *Id.* at 598.

240. See *supra* notes 222-25 and accompanying text.

241. See *supra* note 28 and accompanying text.

242. Moreover, the Court in *ARCO* implied that in the future, the Court may remove from the per se illegal category vertical price-fixing agreements setting maximum prices, without regard to whether a nonprice restraint is involved. 110 S. Ct. 1884, 1889 n.5 (1990).

243. 485 U.S. 717 (1988).

and *ARCO v. USA Petroleum Co.*²⁴⁴ reflect the Court's movement towards per se legality for vertical restraints in general,²⁴⁵ then one must ask if the economic theories asserted to justify this move are valid. Proponents of per se legality argue that a firm's motive to maximize profits through vertical restraints is merely guided by efforts to compete horizontally at the manufacturer level; in other words, to engage in interbrand competition.²⁴⁶ The Chicago School asserts that because manufacturers are driven by competitive forces, the vertical restraints they impose must be in response to those forces and therefore, necessarily are procompetitive as well as economically efficient. If that were not the case, then the restraints would fail to enhance profits, and the firms would abandon them. The restraints' retention is proof in itself of their procompetitive impact. Thus, Chicago School proponents argue, the marketplace effectively polices manufacturers' conduct to ensure competitive behavior, rendering antitrust scrutiny of vertical restrictions not only unnecessary, but also a waste of society's resources and a harmful impediment to firms' efficient activities as well.²⁴⁷

The critical link in this analysis is the presumption that any effort on the manufacturer's part to maximize profits through vertical restraints must be economically efficient and procompetitive. The traditional argument against the Chicago model is that firms can use vertical restraints to facilitate cartelization; that is, horizontal price-fixing, at either the manufacturer or dealer level.²⁴⁸ If cartelization occurs, market prices are maintained artificially above the competitive level—clearly an anticompetitive result.²⁴⁹ Debates addressing the validity of the cartelization concern focus both on the likelihood of its occurrence and on the social costs of either overly broad prohibitions or excessive permissiveness toward vertical price restraints.²⁵⁰ Furthermore, some question remains whether or not cartelization, if it occurs, cannot be remedied adequately through antitrust scrutiny of horizontal restraints, thereby obviating the need to examine any vertical conduct.²⁵¹ In these debates, both the Modern Populists and the Chicago School proponents advocate polar positions of per se rules for vertical price restraints: the former

244. 110 S. Ct. 1884.

245. See *supra* notes 189-242 and accompanying text.

246. See, e.g., *supra* note 28.

247. See BORK, *supra* note 4, at 280-98.

248. See, e.g., Bork, *supra* note 66, at 137; Lawrence A. Sullivan, *The Justice Department Guidelines on Mergers and Vertical Restraints: A Critique*, 16 ANTITRUST L. & ECON. REV. 11, 18-19 (1984).

249. See *infra* notes 257-61 and accompanying text; see also *infra* text accompanying note 196.

250. Compare, e.g., Resale Price Maintenance and Antitrust Policy, 1985 CONTEMP. POL'Y ISSUES 9, 15 ("[I]f anticompetitive instances were frequent but hard to prove, neither a rule of reason nor a rule of per se legality may be appropriate.") with Posner, *supra* note 28, at 8 (arguing that declaring "purely vertical restrictions on distribution" legal would create a judicially manageable standard compared to the rule of reason or the illegal rule).

251. See *infra* text accompanying notes 273-75.

advocate per se illegality²⁵² and the latter advocate per se legality.²⁵³

At the crux of the discourse is the assumption, on both sides, that cartelization is the primary means through which an industry, populated by more than one firm, can engage in industry monopoly pricing, that is, price above competitive levels. Recent developments in economic theory show that manufacturers' ability to distribute goods through retailers (as opposed to selling directly to consumers) induce the manufacturers and the retailers to engage in non-cartelizing strategic pricing behavior—conduct that opens up the possibility of industry-wide monopoly retail pricing without any assistance from cartelization efforts.²⁵⁴ An evaluation of both per se legalization and per se illegalization of vertical price restraints in this context demonstrates that extreme antitrust rules can create impediments to certain market forces that otherwise would countermand the high industry pricing levels arising from the distributors' strategic (and legal) pricing activities. As will be seen, in those retail market environments in which per se legality erects significant anticompetitive barriers, the market force impeded is the underappreciated intrabrand price competition²⁵⁵ that the Modern Populists have argued so vigorously to protect.²⁵⁶ On the other hand, per se illegality inhibits the demonopolization of prices that otherwise would occur when the manufacturers' optimal profit-maximizing strategy is to set price maximums for retailers, forcing them to lower prices. In some instances, the demonopolization of retail prices even may require that manufacturers enter into agreements with each other to set and enforce these maximum retail prices. Currently, such conduct would violate not only laws against vertical price restraints but also those prohibiting horizontal price restraints, and would be treated as illegal per se.²⁵⁷

The market structures analyzed in the noncartel context are not

252. See *supra* note 67.

253. See *supra* note 28.

254. For recent developments in economic analysis of manufacturer's strategic behavior, see B. Douglas Bernheim & Michael D. Whinston, *Common Marketing Agency as a Device for Facilitating Collusion*, 16 RAND J. ECON. 269 (1985); Giacomo Bonanno & John Vickers, *Vertical Separation*, 36 J. INDUS. ECON. 257 (1988); Michael L. Katz, *Vertical Contractual Relations*, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION (Richard Schmalensee & Robert D. Willig eds., 1989); Patrick Rey & Joseph Stiglitz, *Vertical Restraints and Producers' Competition*, 32 EUR. ECON. REV. 561 (1988); Greg Shaffer, *Capturing Strategic Rent: Full-Line Forcing, Brand Discounts, Aggregate Rebates, And Maximum Resale Price Maintenance*, 39 J. INDUS. ECON. (1991); Thomas J. Hoerger & Andrew W. Horowitz, *Retailers as Buffers: Substitutability and Optimal Retail Structure* (Jan. 1991) (unpublished manuscript, on file with *The George Washington Law Review*).

255. See, e.g., *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51-59 (criticizing the Court's decision in *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967), for inappropriately emphasizing intrabrand competition at the expense of interbrand competition).

256. See *infra* notes 282-94 and accompanying text.

257. See *infra* notes 295-310 and accompanying text.

obscure artifacts created by economic ivory tower ponderings. They represent those instances when it is in the manufacturer's interest to use a common retailer to distribute its goods. A common retailer is one who carries the products of several competing manufacturers and is not a franchise outlet for one manufacturer alone. The use of common retailers by manufacturers comprises a substantial portion of consumer marketing, from supermarkets and department stores to specialty shops carrying many brands of particular types of goods. The antitrust implications of such noncartel market structures are consequential. To better understand them in light of *Sharp* and *ARCO*, however, first requires a consideration of *Sharp* and *ARCO*'s economic impact on the regulation of cartel activity.

A. Cartelization: The Traditional Vertical Price Restraint Concern

1. The Nature of the Threat

When manufacturers engage in horizontal price-fixing, they collectively agree to raise prices above the competitive levels by reducing the amount of output sold,²⁵⁸ a consequence economists

258. The impact of horizontal price-fixing can be seen readily through the following graph:

FIGURE I

D, the demand curve, represents various combinations of price and quantity that consumers are willing to purchase. It indicates the higher the price of each good, the lower the quantity consumers are willing to purchase and vice versa. *S*, the supply curve,

consider anticompetitive. Antitrust laws also view horizontal price-fixing as anticompetitive and treat them as per se illegal.²⁵⁹ The incentive for firms to engage in horizontal price-fixing arises when the agreement can increase prices sufficiently to offset more than the drop in revenue due to lower sales, so that overall profit levels rise.²⁶⁰

Horizontal price agreements, however, also create a strong incentive for each manufacturer to cheat. By reducing its price slightly below the agreement price, one manufacturer can expand its sales and market share dramatically, increasing its profits even further, but it does so only at the expense of the lost sales of those who continue to maintain the higher prices.²⁶¹ The cheating firm, of course, must act in secrecy, otherwise the other firms will follow suit to avoid losing customers. Eventually, however, all firms will be forced to lower prices to keep their customers, and prices will fall back to the original competitive levels. Therefore, in order for price-fixing agreements to be successful, monitoring each manufacturer's price to detect cheaters is of paramount importance.

Complications arise, however, when pricing is set at the retail level, but the agreement is made at the manufacturer level. The manufacturers may agree not to compete with respect to price, but if retailers are permitted to pursue intrabrand price competition, the variations in the retail price of the manufacturers' products makes it difficult for producers to assure adherence to the agreement.²⁶²

shows the sum total of the quantities of goods each producer is willing to supply at each price if he or she is acting independently. Under competition, the market forces drive the equilibrium price and quantity to C , where at price P_c , the quantity demanded by consumers and the quantity willingly supplied by producers when operating independently, are equal. If producers enter an agreement to collectively restrict supply to Q_c , they could raise the market price each unit of the good would sell for to P_f . These were the admitted circumstances in many of the early price-fixing cases, such as *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897), and *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

259. See *Socony-Vacuum*, 310 U.S. at 218.

260. Clearly, the firms would have no incentive to engage in horizontal agreements to raise prices, given the necessity of restricting output to do so, unless each firm's profits after the agreement were greater than before the agreement. These increased profits would be ensured if the resulting percentage increase in price would be greater than the percentage decrease in quantity (in other words, if the demand curve of the industry is inelastic). Looking at the graph *supra* note 258, this would mean that the area of rectangle P_fHQ_c , which would represent the industry total revenue, would exceed the area of rectangle P_cQ_cO , the total revenue before the price agreement.

261. If one firm lowers its price slightly below all the other firms, customers presumably will shift their purchases to the lower priced firm.

262. It is unclear what would constitute a price agreement in this case. A definition is hard to ascertain at the manufacturer level. Cartelizing manufacturers may want to continue nonprice competition (to woo customers given the restrained level of output), and if a manufacturer reduces its wholesale price so that the retailer can afford the nonprice activity, a cartel may not want such activities to count as price competition for purpose of agreement.

Controlling and monitoring retail prices is the most effective means that producers have of detecting those who deviate from the agreement. Prohibiting retail price competition makes it easier for manufacturers to ascertain whether the price agreement is being violated. These arguments favor condemnation of vertical price restraints because the restraints are viewed as facilitating horizontal price-fixing at the manufacturer level.

Just as vertical price restraints imposed by the manufacturer on dealers can facilitate cartelization among manufacturers, they also can facilitate cartelization among dealers. The dealers can determine a price level that will maximize joint profits among dealers (which would be above the competitive price) and then demand that the manufacturer impose that price on all dealers. Imposition of vertical price restraints by the manufacturer in this instance would serve two purposes. First, vertical price restraints would enable dealers to detect price cheaters just as they so enabled manufacturers. Second, vertical price restraints provide an effective enforcement mechanism (one not available to manufacturer cartels)²⁶³ because manufacturers can terminate violating dealers, leaving the remaining dealers to operate under their agreement. Thus, condemnation of vertical price restraints serves not only to deter horizontal price-fixing among manufacturers, but also to deter that practice among dealers as well.

2. *The Threat of Cartelization After Sharp*

Justice Scalia, despite his leanings towards Chicago School analysis (which considers the cartelization threat insignificant),²⁶⁴ acknowledged in *Sharp* that the possibilities of cartelization might warrant maintaining a per se illegal rule for vertical price restraints.²⁶⁵ But in justifying the Court's narrowing of the scope of per se illegality, he also argued that such cartelization was unlikely to occur unless there was an agreement as to specific price levels. In Justice Scalia's view, "[c]artels are neither easy to form nor easy to maintain. Uncertainty over the terms of the cartel, particularly the

263. For cartelizing manufacturers, when faced with a noncomplying member, often the cartel's only resort is to abandon the agreement altogether and allow prices to fall to their natural competitive levels. Because the incentive to cheat is so strong, it is usually the basis of the economic arguments that cartels cannot survive in the long run and therefore do not justify preventing per se legal rules. How long it takes, however, for the long run to take effect is uncertain. For example, the OPEC oil cartel lasted over ten years while economists, from the moment of OPEC's inception, were continuously predicting its imminent collapse. See, e.g., D.K. Osborne, AM. ECON. REV. 835, 836 (1976) ("[W]hen the Organization of Petroleum Exporting Countries (OPEC) formed their cartel in October 1973, many economists (myself included) predicted that it would collapse within a year. It is now thirty-six months later, and the cartel seems pretty healthy."). In fact, OPEC wreaked considerable world-wide economic havoc before market forces caused it to unravel.

264. See, e.g., BORK, *supra* note 4, at 293 (stating that "[t]he proposed legality of vertical restraints need not be questioned on the theory that it would enable successful and undetectable horizontal reseller cartels").

265. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 725-26 (1988).

prices to be charged in the future, obstructs both formation and adherence by making cheating easier."²⁶⁶

Effective dealer cartelization, however, easily can occur even if the dealers do not agree to a specific price level with the manufacturer; the dealers merely can demand the termination of a discounter, as Hartwell did in *Sharp*.²⁶⁷ Repetition of this behavior ultimately will make clear the price levels the dealers want to maintain, without any explicit mention of price.²⁶⁸ Because agreements as to price are missing, under *Sharp*, such activities would not be considered vertical price restraints. But they also would escape rule of reason analysis because no nonprice activity is involved.²⁶⁹ Guided just by *Monsanto Co. v. Spray-Rite Service Co.*,²⁷⁰ a court would correctly judge the above-described activity as per se illegal because of the absence of independent activity by the manufacturer.²⁷¹ But with the additional requirement of finding agreements as to specific price levels mandated by *Sharp*, the activity would fall into the de facto category of per se legality that the opinion creates.²⁷² Yet there is no question that this activity is anticompetitive.

3. The Case for Rule of Reason

One possible counterargument to criticisms of *Sharp* may be that even if vertical price restraints are made legal, thereby facilitating manufacturers' and dealers' horizontal price-fixing, if the firms engage in such activity they still will come under antitrust scrutiny for their horizontal price restraints—an issue that the *Sharp* opinion does not address.²⁷³ The difficulty is that horizontal price-fixing agreements are not always readily detectable. Even though the standards for establishing agreements are less stringent in the horizontal cases, cartelizing firms typically will not leave smoking guns or paper trails, making detection difficult.²⁷⁴ Thus, because vertical price arrangements can serve as a springboard to horizontal ones, a possibility even Justice Scalia acknowledges,²⁷⁵ and given the difficulties of discovering horizontal restraints, keeping vertical restraints subject to review by the courts is certainly a reasonable safeguard.

266. *Id.* at 727.

267. *Id.* at 721.

268. Justice Scalia rejected this assertion. *See id.* at 731.

269. *See supra* text accompanying notes 213-25.

270. 465 U.S. 752 (1984).

271. *See supra* text accompanying notes 172-76.

272. *See supra* text accompanying notes 213-25.

273. *See, e.g.,* Hovenkamp, *supra* note 25, at 534; Piraino, *supra* note 75, at 336 n.116.

274. *See* Saul Levmore, *Rescuing Some Antitrust Law: An Essay on Vertical Restraints and Consumer Information*, 67 IOWA L. REV. 981, 993 (1982).

275. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 725-26 (1988).

On the other hand, given that vertical arrangements often have not only price impacts but legitimate competitive purposes as well, such as guarding against free riders²⁷⁶ and blocking retail supracompetitive pricing,²⁷⁷ per se illegal treatment seems too strong. A rule of reason approach in which courts can assess the conduct's market effect on a case-by-case basis is best suited to maximize the legalization of efficient restraints while minimizing erroneous judicial rulings as to the competitive nature of the litigated corporate behavior.

A useful standard in this context could be to determine whether an economic justification for the vertical price restraints exists, such as protecting against free riders, which can be evidence of independent action by manufacturers as permitted by *Monsanto*.²⁷⁸ If no such justification can be shown, however, the court should then declare the restraint to be a violation of antitrust law. Such a standard would be in accord with the reasoning in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,²⁷⁹ in which the Court stated, in the context of a monopolization claim, that if no economic efficiency justifications could be provided, and a potential anticompetitive effect loomed large, the restraint would be invalidated.²⁸⁰

B. New Developments in Economic Theory: Industry Monopoly Pricing Without Cartelization

Given that horizontal cartelization does come under antitrust scrutiny, the question still remains whether the legalization of vertical price restraints will lead to noncompetitive pricing when cartelization is not present, with or without agreements as to specific price levels. Recent developments in economic theory demonstrate in an economically rigorous manner that when manufacturers choose to use retailers to distribute their goods, there are circumstances that lead to industry monopoly pricing without a horizontal agreement, express or implied, on either the manufacturer or dealer level.²⁸¹

1. When Per Se Legality Prevents Procompetitive Conduct

An important phenomenon occurs when a manufacturer's profit maximizing strategy is to sell its goods to a common retailer, such as a supermarket, which carries the products of competing manufacturers. When a common retailer is the manufacturer's optimal choice, the manufacturer's profits are enhanced because the retailer acts as

276. See *supra* notes 159-66 and accompanying text. But see *infra* text accompanying notes 311-31.

277. See *infra* text accompanying notes 295-309.

278. *Monsanto Co. v. Spray Rite Serv. Corp.*, 465 U.S. 752, 758-59 (1984); see *supra* notes 172-76 & 181-82 and accompanying text.

279. 472 U.S. 585 (1985).

280. *Id.* at 605.

281. See *supra* note 254.

a buffer between different manufacturers, mitigating price competition among them.²⁸² The retailer has no incentive to pit one manufacturer's goods against another's by lowering each product's price because that merely reduces the revenue to the retailer. It can be shown that the retailer, in maximizing his own profits, independently will choose to maintain all retail prices at a level that also maximizes the joint profits of all the manufacturers, which is the equivalent to the industry monopoly or collusive price. On the other hand, if manufacturers market their goods independently or through exclusive franchises, they may be forced, through price competition at the retail level, to reduce their prices to competitive levels, and thus decrease their profits.²⁸³ Therefore, when manufacturers engage in appropriate strategic behavior, retailers may choose cartel prices without any cartels occurring.

Understanding the individual common retailer's incentive to price at the monopoly level enables one to extrapolate what the market dynamics are when a marketplace consists of many of these common retailers, for example, when there are several supermarkets in the community. Strong incentives exist for one retailer to reduce its price slightly to expand its market share significantly at the expense of the others, just as when there is a cartel.²⁸⁴ The retailer's incentive is a classic example of intrabrand price competition spurring price discounting. If left unfettered, the ultimate result will be that market prices will fall to competitive levels.²⁸⁵ If, however, manufacturers are permitted to engage in vertical price-fixing, because,

282. Although the use of common retailers is assumed in some articles, *see, e.g.*, Shaffer, *supra* note 254, a recent article by Professors Thomas J. Hoerger and Andrew W. Horowitz, *see supra* note 254, is the first to demonstrate rigorously when it is optimal to use common retailers. Professors Hoerger and Horowitz show that the manufacturer's optimal marketing strategy depends on how close substitute competing brands are to each other, and to what extent the manufacturer can share in the retailer's supranormal profits. The greater the substitutability or the percentage of profit share, or both, the more likely it is optimal for the manufacturer to prefer the common retailer. *Id.* at 6-20. Although profit-sharing between manufacturer and retailer often may not be observed formally, the constant communication between manufacturer and retailer as to "how business is doing" as is described in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763-64 (1984), affords the manufacturer the opportunity to adjust regularly its wholesale prices to capture, in effect, a share of the profits. A different model, *see Hoerger & Horowitz, supra* note 254, shows that the common retailer is preferred over a franchise or direct competition between manufacturers because the common retailer enables the manufacturers to achieve the collusive (or monopoly) price. *See Bernheim & Whinston, supra* note 254.

283. *See Hoerger & Horowitz, supra* note 254.

284. *See supra* notes 260-62 and accompanying text.

285. Prior to the price discounting, the manufacturer and all the common retailers are sharing supranormal profits because price is at the industry monopoly price. Any one of the retailers, however, has an incentive to start discounting the retail price slightly so that its sales of goods that generate additional supranormal profits will increase. The other retailers will be unhappy because they will lose customers. The manufacturer will be unhappy because even though his profits from the price-discounter will

say, of per se legal antitrust treatment, then the intrabrand price competition will be impeded and retailers will maintain their monopoly pricing. Furthermore, neither the manufacturers nor the retailers will be subject to antitrust scrutiny because no horizontal agreements underlie the conduct. Therefore, legalizing vertical price restraints actually becomes the primary means for creating and maintaining industry-wide monopoly pricing in widely prevalent contexts and does so by subverting the natural and, in these circumstances, important forces of intrabrand competition.

Reliance on interbrand competition to resolve these excessive price levels (as the *Continental T.V., Inc. v. GTE Sylvania Inc.*²⁸⁶ and *Sharp* opinions do to justify permitting vertical nonprice restraints)²⁸⁷ is to no avail here because, when manufacturers elect to use common retailers, no interbrand competition exists. Per se legality for vertical price restraints, moreover, makes the use of a common retailer even more attractive to the manufacturer, because it assures that the manufacturer will be able to derive the benefits of industry monopoly pricing. In these circumstances, therefore, unconstrained vertical price restraints actually would decrease interbrand and intrabrand competition as well as consumer welfare. Clearly, the antitrust implications of the common retailer market structure contrast considerably with the traditional view that vertical price restraints enhance interbrand competition.²⁸⁸ Given the widespread use of common retailers, such antitrust implications cannot be ignored.

Because vertical price restraints can foster monopoly pricing for a considerably broader range of markets than previously thought, creating per se legality for vertical price fixing is tantamount to opening the door to those dangers. It is difficult to believe that manufacturers and retailers will not engage in such supracompetitive pricing activities if they will enhance profits. Early antitrust history shows that firms lack no inhibitions to engage in monopoly

increase, that increase will be more than offset by the reduction in profits received from the other retailers due to their lost sales. The net loss occurs because as prices fall, any price below the monopoly price represents lower total profits to be shared. By definition, the monopoly price is the one that maximizes profits. The insight of the economic analyses cited *supra* note 282 is the demonstration that through strategic wholesale pricing schemes, the manufacturer can induce the common retailer to elect on his own to charge the monopoly price. But once again, these economic analyses do not place the common retailer in a marketplace with many common retailers, as this Article does.

Once one retailer starts to discount, unless some restriction is in place that allows the manufacturer and other retailers to stop the discounter (such as per se legality for vertical price restraints), the natural course will be that the other retailers will have to lower their prices to compete effectively with the price-discounter. The end result is that all retailers reduce prices to competitive levels and the supranormal profits no longer accrue to any of the parties. This analysis explains why one commonly observes lower prices in larger urban areas where many common retailers exist and higher prices (or at least prices closer to the "suggested retail prices") in smaller town environments where very few, if more than one, common retailers exist.

286. 433 U.S. 36 (1977).

287. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 725 (1988); *Sylvania*, 433 U.S. at 52 n.19.

288. See *supra* notes 60-61 and accompanying text.

pricing.²⁸⁹ Antitrust law effectively has suppressed the more overt manifestations of horizontal cartelization activities, which explains why there is not a greater incidence of that conduct being condemned today. If, however, antitrust scrutiny of vertical price restraints is eliminated altogether—and *Sharp* may have indeed set the groundwork²⁹⁰—one can expect an upsurge in industry-wide monopoly pricing, the antithesis of procompetitive and economically efficient business behavior. Finally, the conduct will escape any other antitrust review because horizontal restraints also are not involved.

Given the anticompetitive threat that vertical price restraints might pose, creating per se legality for them seems unwarranted. Because vertical price restraints may encourage supracompetitive pricing policies at the manufacturer and retailer levels, something that is neither remote nor insubstantial, the door should remain open for judicial review of possible anticompetitive conduct. Concededly, such a review requires a larger expenditure of judicial resources than required with per se legality.²⁹¹ Yet, the courts long have warned that serious harm could result from cursory antitrust judgments,²⁹² suggesting that the conservation of judicial resources through extensive applications of per se rules can be inappropriate. Furthermore, the sophistication that economic theory recently has developed in recognizing various market structures and corporate strategic behavior, can render a rule of reason approach far more efficient in its analysis, as well as more subtle.²⁹³

Just as per se illegal rules should be reserved only for conduct that is always or nearly always anticompetitive, per se legal categorization should apply only when the conduct is inherently procompetitive. Because it is now evident that vertical price restraints have a strong anticompetitive potential, as well as a procompetitive effect, rule of reason scrutiny, which allows consideration of both possibilities, is the correct judicial approach.

289. See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897).

290. See *supra* text accompanying notes 222-25.

291. This has been one of the most frequently given reasons for maintaining a per se rule, whether the proponent is advocating per se legality or per se illegality. See, e.g., BORK, *supra* note 4, at 288; William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 1001 (1985) (advocating the per se illegal rule in the interest of "judicial economy" even if some procompetitive behavior becomes prohibited).

292. See, e.g., *Poller v. Columbia Broadcasting Sys.*, 368 U.S. 464, 473 (1962) (stating that "summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles"). Even Justice Scalia in *Sharp* announced that the rule of reason analysis should be the norm. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988).

293. See *infra* notes 332-49 and accompanying text.

2. When Per Se Illegality Promotes Anticompetitive Behavior

Just as the Chicago School's penchant for per se legality creates barriers against significant procompetitive business behavior, the Modern Populist School's penchant for per se illegality fosters market dynamics that reduce consumer welfare. The phenomenon of manufacturers setting maximum prices above which retailers cannot charge provides a good vehicle for examining the danger of blanket per se rules against all forms of vertical price restraints, a position the Modern Populist School seeks to maintain.²⁹⁴

Intuitively, one might conclude that there are no ill effects from maximum price limits because it means that manufacturers are setting lower prices and probably selling more output than otherwise, an effect that is in consumers' interest. Nonetheless, the Modern Populist School argues that maximum price-setting should be prohibited because it constitutes price-fixing that might, in turn, lead to manufacturers setting minimum prices, an activity known as resale price maintenance. Resale price maintenance, the Modern Populists assert, will result in prices above competitive levels.²⁹⁵ Furthermore, even though lower prices sometimes may occur, the permission to set prices is so fraught with the danger of resale price maintenance that its prevention would require policing entire industries, a drain on society's resources.²⁹⁶ The most efficacious and expedient course, the Modern Populist School concludes, is treat all of vertical price-fixing as per se illegal.²⁹⁷

The Modern Populist School's assumption that maximum price-setting's potential for minimum price-setting is pervasive and costly to contain if not prohibited outright, is not necessarily correct, although it has powerful intuitive appeal. Moreover, in certain market structures involving common retailers, discussed below, the setting of maximum prices is the only means of lowering prices to competitive levels for consumers.²⁹⁸ In fact, in those market contexts, the price-fixing conduct is amenable to quick and efficient rule of reason evaluation when proper guidelines and standards are in

294. See *supra* note 67 and text accompanying notes 258-63. Professor Robert Pitofsky suggests, however, that price maximums should be judged under the rule of reason. Pitofsky, *supra* note 67, at 1490 n.17.

295. See, e.g., John J. Flynn & James F. Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. Rev. 1125, 1149 (1987) (arguing that "[i]n cases where maximum price fixing takes place, be it horizontal or vertical, the markets involved are usually characterized by a virtually complete departure from the ideal of a perfectly competitive market") (footnotes omitted); see also *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 342-45 (1982); *Albrecht v. Herald Co.*, 390 U.S. 145, 152-53 (1968).

296. See *supra* text accompanying notes 258-63. The Modern Populist School, of course, did not anticipate the problems generated by resale price maintenance brought on by manufacturers' use of common dealers. See *supra* notes 282-89 and accompanying text. They could, however, add that scenario to their arguments as well.

297. See, e.g., *Maricopa County*, 457 U.S. at 342-43; *Albrecht*, 390 U.S. at 152-53; *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211, 213 (1951).

298. See *infra* notes 302-08 and accompanying text.

force, adequately safeguarding against the emergence of anticompetitive resale price maintenance.²⁹⁹ On the other hand, if the Modern Populist method of preventing the potential for minimum price-fixing through per se illegality of any price-fixing continues to prevail, then the economic consequences will be supranormal prices in those markets for which maximum-price setting is the only means to prevent high prices from occurring.

The common retailer market structure in which a manufacturer will wish to impose ceilings so that prices will be reduced³⁰⁰ occurs

299. See *infra* text accompanying notes 306-10.

300. The manufacturer's optimal sales and retail price level can be determined by the following graphical analysis.

FIGURE II

D represents the demand curve for goods; *MR* represents the marginal revenue each additional sale will bring into the firm, acknowledging that in order to sell the additional unit, the sales price has to fall. *MCM* represents the manufacturer's marginal cost of producing each unit. The manufacturer maximizes his or her profits by selling enough units so that the marginal cost of the last unit sold equals its marginal revenue, which is represented on the graph as point *B*, with associated output level, Q_{MM} . The optimal retail price for the manufacturer is P_{MM} . If the retailer wishes to charge above this price, which can happen, see *infra* note 303, the manufacturer will wish to impose price-ceilings on its retailer.

when the retailer's optimal retail price is higher than the optimal one for the manufacturer.³⁰¹ If the retailer charges its higher price,

301. Just as with the manufacturer, the retailer maximizes profits by selling at the level of output in which the marginal cost to the retailer of the last unit sold equals the marginal revenue. The retailer, however, has two components to its costs. One is its own marginal cost curve from "running the store." The other is the wholesale price that the manufacturer charges the retailer for each unit. The graph below shows what the wholesale price would have to be to induce the retailer to charge and sell the manufacturer's desired retail price and quantity.

FIGURE III

D is the demand curve and MR is the marginal revenue curve as before. WP is the wholesale price the manufacturer charges the retailer. $MCR + WP$ represents the sum of the retailer's own marginal cost of "running the store," MCR , and the wholesale price. Notice that in this graph, the manufacturer has chosen a wholesale price such that when it is added to the MCR , the retailer's optimal quantity and price are exactly as desired by the manufacturer from figure two. See *supra* note 300. In other words, the retailer charges P_{MM} and sells Q_{MM} .

The manufacturer, however, is losing money at this wholesale price because it is clearly less than the manufacturer's own marginal cost. See *supra* note 300. In this case, the manufacturer can earn profits only if it can extract the retailer's supranormal profits, which some economists suggest can be done by charging a licensing fee. See, e.g., Bonanno & Vickers, *supra* note 254; Rey & Stiglitz, *supra* note 254. Professor Greg Shaffer points out, however, that the licensing possibility is only an assumption that the authors of the earlier works make and may not be available in all circumstances. Shaffer, *supra* note 254, at 21. Furthermore, Professor Shaffer points out that licensing may not be a possibility when the manufacturer is competing with other manufacturers for "shelf space" at a common retailer. *Id.* The retailer can pit the manufacturers against each other to get them to reduce their licensing fees, perhaps even to zero.

The alternative, then, is for the manufacturer to consider what the optimal wholesale price should be given that the retailer will choose a different retail price (and therefore

sales to the manufacturer will decline, causing the manufacturer to lose profits.³⁰² If the manufacturer sets a maximum retail price, it changes the retailer's profit-maximizing decisions, and, as a result, the retailer will elect to sell more goods, and at a lower price.³⁰³ Although the manufacturer always will seek to set lower prices in such situations, it will not be able to do so if vertical price restraints are per se illegal.

There also are circumstances in which, even if vertical price fixing were not per se illegal, the manufacturer's imposition of a price maximum still would not be sufficient to achieve lower prices. If many manufacturers are competing with other brands, a retailer can threaten to refuse to carry the goods of a manufacturer who is alone

sell a different quantity) than what the manufacturer otherwise would like. The manufacturer has to find a wholesale price that will maximize its profits, given the retailer's response. Figure IV shows that as the manufacturer increases its wholesale price, so will the retailer increase the retail price, thereby reducing the quantity of the good sold.

FIGURE IV

302. See *supra* note 302.

303. Ideally, the manufacturer can overcome the retailer's incentive to charge high prices by setting price-maximums, as in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). The manufacturer can set a price ceiling at P_{MM} , and charge a wholesale price sufficiently below that so that the retailer can earn a normal profit rather than the supra-normal profits it would earn in the previous cases.

in setting a price maximum. Then, in order for a price maximum to be effective, all the manufacturers need to enter into an agreement to enforce it.³⁰⁴ To permit such agreements to be made would require the courts to adopt a rule of reason approach to horizontal price-maximum agreements as well as to vertical price restraints. Under current antitrust law, the general per se prohibition against horizontal price agreements would not allow such price-reducing conduct.³⁰⁵ Because the courts have chosen, however, not to categorize other horizontal price agreements as per se illegal because of their procompetitive effects,³⁰⁶ there seems to be no reason for them not to fashion similar antitrust accommodations for those common retailer market structures that warrant it.

The common retailer market structure provides built-in safeguards against the abuse of more flexible antitrust treatments. If economic circumstances change so that the manufacturer's incentive becomes to seek to set minimum prices to facilitate cartelization, implicitly the stage is set for some retailer to become a price-discounter.³⁰⁷ Once price discounting begins, the manufacturer either will abandon the minimum prices or terminate the dealer. If the

FIGURE V

304. Professor Shaffer also suggests that some relaxation of antitrust laws might be appropriate in this case. See Shaffer, *supra* note 254.

305. *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 327 (1982).

306. See, e.g., *BMI v. CBS*, 441 U.S. 1 (1979).

307. See *supra* notes 260-61 & 286.

latter occurs, the terminated discounter will sue, alleging vertical price-fixing. As long as vertical price-fixing is in the rule of reason category (and the *Sharp* standard does not apply), the courts will be able to find the termination of the price-discounter anticompetitive and therefore illegal. Thus, a properly guided rule of reason analysis allows those price-fixing situations that the Modern Populist School wants to prevent to be declared illegal, while it validates those price-fixing agreements that foster efficiency, the primary concern of the Chicago School.³⁰⁸ With appropriate rule of reason criteria, the wrongfully terminated dealer will have nearly as much protection in the courts as with a per se illegal rule for vertical price restraints, but without the attendant social costs of impeding other corporate behavior that is procompetitive. Given these possibilities, per se illegal treatment of all vertical price restraints seems unnecessary and detrimental to consumer welfare.

C. Protecting Against Free Riders

Another argument justifying per se legality for vertical restraints, the concern about free riders, also assumes that all efforts by manufacturers to engage in interbrand competition are necessarily the most efficient and in the best interest of consumers.³⁰⁹ Because manufacturers often seek to implement interbrand strategies at the retailer level, they often want to force retailers to follow their policies. Vertical restraints are viewed by many courts and scholars as the most effective means for accomplishing this purpose.³¹⁰ In particular, vertical price restraints are considered an important mechanism to prevent some retailers from free riding at the expense of those retailers adhering to the manufacturers' strategies.³¹¹ It is not clear, however, that vertical price restraints are in fact the most effective means of guarding against every instance of free riding. Even in those cases where vertical price restraints appear to be the only recourse to stopping free riding, it is still questionable whether it is in the consumers' best interest to allow the manufacturer to do so.

308. See *supra* note 6 and accompanying text.

309. See *supra* notes 61-64.

310. See *supra* notes 61-64.

311. See *supra* notes 61-64. For a general discussion of free riding, see *supra* text accompanying note 62.

1. *When Vertical Price Restraints Are Not the Best Means for Preventing Free Riding*

a. *Post-Sales Services*

By imposing vertical price restraints, the manufacturer forces retailers to compete with each other through nonprice methods, such as providing better customer services, particularly those services that the manufacturer deems effective in attracting customers in the interbrand market.³¹² For example, if the manufacturer finds that providing post-sales services (such as repairs and maintenance) will make its product more appealing to consumers, it can require the retailer to provide them. The question is how the manufacturer can assure that the retailer will make every effort to make those services available.

If the manufacturer elects to sell the goods and the post-sales services as one package with one price, a number of problems can arise. A discounting retailer may choose to provide shoddy and therefore cheaper post-sales services to facilitate its ability to charge lower prices. This leaves the manufacturer with two options. One is to allow the consumer access to any retailer for post-sales services regardless of where the product was purchased. The problem with this option is that not all consumers will discover which retailer provides good services, and even when consumers do, that retailer will not receive compensation for the quality service it does provide because it did not make the initial sale. The result will be an increased proportion of consumers purchasing the goods from the price discounter and servicing the goods at the full service stores. Because the profitability to the retailer of providing quality service will be diminished, so will the availability of the quality service, which defeats the manufacturer's initial purpose.

The manufacturer's second option is to require the consumer to take any necessary post-sales service from the store where the original purchase was made, thus forcing the consumer to absorb the costs as well as the benefits of the discount price. The problem is that the manufacturer will not achieve as much reputation enhancement from providing quality post-sales service that it seeks to increase its sales.

Vertical price restraints, it is argued, provide the manufacturer with a third alternative, one that can safeguard against either of the other two undesirable outcomes.³¹³ If the manufacturer may engage in resale price maintenance, the price discounter will be unable to reduce its prices and consumers will have no incentive to purchase from a particular dealer because of its price. If, in conjunction with resale price maintenance, the manufacturer requires that customer service be available only from the store where the good was bought, then it behooves the consumer to select the store

312. See, e.g., Piraino, *supra* note 28, at 6-7; Posner, *supra* note 25, at 6; Sullivan, *supra* note 43, at 786.

313. See *supra* note 28.

providing the best service because price is no longer an issue. Given the customer's efforts to maximize the benefits received from the dollars spent, competition among retailers drives each to provide the best post-sales service possible so as to increase sales. Therefore, not only will the stores be compensated for these services, but the quality of their service will enhance sales overall as well. The resulting increase in sales and service quality is clearly in the consumers' interest, a value that the Chicago School argues should be antitrust law's primary goal.³¹⁴

The question is whether vertical price restraints are the only or the most effectual means for accomplishing these ends. If the manufacturer elects instead to "unbundle" its goods,³¹⁵ that is, sell the good separately from the service, consumer welfare, as shall be seen, can be enhanced even further than when vertical price restraints are employed. The unbundling approach also will not expose society to the potential anticompetitive threats that vertical price restraints do.

If the manufacturer unbundles the goods from the service and permits the consumer to select the retailer of choice, both at the time of sale and at the time of service, retailers can compete with regard to both the price of the good and the price and quality of service. The consumer thus will gain the benefit of lower prices from intrabrand competition and still have access to quality post-sales services. In addition, the consumer is not forced to pay for the post-sales services imposed by vertical price restraints, services that some consumers may not want or want to pay for.³¹⁶ Finally, as is often the case when there is a trade off between price and service, a range of different combinations of the two may be offered in the marketplace; some stores will sell the best service for the highest price while others will provide the minimal service for the lowest price, with other stores making available various combinations of price and service in between.³¹⁷ A range of price-quality combinations in the marketplace enhances consumer welfare because consumers are able to tailor their consumption of services more closely to their tastes and income needs. And, in fact, providing a low-cost, no-service option to the consumer is one function a free rider

314. See, e.g., Easterbrook, *supra* note 4, at 32; Kelly, *supra* note 40, at 366; Posner, *supra* note 28, at 21.

315. "Bundling" and "unbundling" goods and their impact on consumer welfare is a subject frequently addressed by economists over the years. See, e.g., Sherwin Rosen, *Hedonic Prices and Implicit Markets: Product Differentiation in Pure Competition*, 82 J. POL. ECON. 34 (1974).

316. For example, the consumer may be quite handy with the product and enjoy working on it as a hobby.

317. Dry cleaning establishments are a good example, offering a range of price-quality combinations to the public.

b. Advertising

Vertical price restraints also can safeguard against the free rider's impact on local advertising. If the discounter refuses to participate in collective advertising by other local retailers, it can free ride in two ways. The most obvious is that without paying for it, the free rider nevertheless will benefit from the advertising through increased inquiries and sales arising from the stimulated demand. Because each retailer only will contribute in advertising dollars to the extent that its revenues are increased, if the free rider does not contribute its economic share, the level of collective advertising will be suboptimal, hurting the manufacturer and all the retailers except the free rider who receives his benefits from advertising for free.³¹⁹

The second way the free rider exploits the other retailers by not participating in advertising costs is through its resultant ability to discount prices. The free rider actually can draw many of the new customers away from those dealers who did pay for the advertising, if the customers, in addition to responding to the advertisements, engage in price comparison shopping. Every new customer created by the advertisement who also calls the price discounter to compare price ultimately will buy from the discounter, because its prices will be lower. The impact is to further diminish other retailers' incentive to engage in advertising, which can be detrimental to the manufacturer's overall market share.³²⁰

Although vertical price restraints would resolve this second problem, an even better solution would solve both without the vertical price restraints' anticompetitive risk. The manufacturer can pay for the local advertising and charge all the retailers, including the discounter, a fee for the service by including it in the wholesale price of the goods. The discounter would then have no artificial competitive

318. *Contra, e.g.*, Kelly, *supra* note 40, at 366 ("Typically, both the product and the dealer services associated with it are sold as a package. The fact that bundling meets the market test indicates that it is efficient to do so. To require firms to unbundle such packages at the expense of the consumer is contrary to the intent of the antitrust laws.").

319. Professors (now Judges) Richard A. Posner and Frank H. Easterbrook made a similar point. Professors Posner and Easterbrook noted that in the case of a group of small manufacturers sharing a common trademark, some manufacturers might be tempted not to commit their own resources for advertising in the hope of taking a free ride. See RICHARD A. POSNER & FRANK H. EASTERBROOK, *ANTITRUST* 248-49 (2d ed. 1980). Professors Posner and Easterbrook noted that if manufacturer *B* chooses not to advertise while manufacturer *A* does advertise, manufacturer "*A*'s expenditures have created a market which *B* can exploit at no cost to him; *B* reaps what *A* has sown." *Id.* at 249; see also Jonathan M. Jacobson, *On Terminating Price-Cutting Distributors in Response to Competitors' Complaints*, 49 *BROOK. L. REV.* 677, 682-83 (1983) (noting that argument made in favor of resale price maintenance as a way of combating against free riders is that "[t]he free rider[] . . . will tend to attract customers who have already received the benefit of promotions . . . provided by the higher-priced distributors").

320. See POSNER & EASTERBROOK, *supra* note 323, at 248-49 (noting that free ride may be taken on competitors' advertisement expenditures because having "incurred no advertising expense," the free rider "can profitably undersell" his competitors); Jacobson, *supra* note 323, at 682-83 (noting that according to proponents of rule of reason treatment for vertical price-fixing "distributors not . . . participating in promotions—'free riders'—will have lower costs and will be able to charge lower prices").

advantage attributable to lower costs from free riding, and yet would be free to engage in any intrabrand price competition on a legitimate basis. The consumer would then gain the advantages both from the advertising information and from the lower prices.

2. *Point-of-Sales Services—Services Not Worth Protecting*

The strongest argument in favor of allowing resale price maintenance to guard against free riding problems is the protection of point-of-sales services. Point-of-sales services usually consist of investments the retailer makes to induce customers to purchase their goods. The most typical example, and the one most frequently argued in the courts, is the provision of trained and experienced personnel capable of explaining the product line and helping consumers assess their needs.³²¹ This service is considered valuable for the consumer, particularly when the consumer is dealing with products that are at the high end of technological innovation. Manufacturers often view the provision of such services as crucial to enhancing their market share, and it is in this area that the free riding discounter plays its most irritating role.

Many consumers make their initial inquiry into a product by going to a full service store with experienced personnel. There, a consumer can learn about the available products and how they meet the consumer's needs. Often, after collecting sufficient information from expert salespeople at the full service store, the consumer makes a decision but then purchases the chosen products through a price-discounting retailer, a retailer who can charge lower prices because it provides no point-of-sales services, or because it has little retail overhead, such as a mail-order outlet.³²² Because the full-service store pays the cost of the experienced professional sales force, it cannot compete in price. If the full service store fails to make the sales necessary to cover its personnel costs, its incentive to provide those services is diminished greatly.

321. *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), provides an excellent example. In that case, one of Monsanto's criteria for renewing the contracts of its distributors was "whether the distributor employed trained salesmen capable of educating its customers on the technical aspects of Monsanto's herbicides." *Id.* at 756. Spray-Rite, the terminated dealer, had only one salesman on its payroll. *Id.*; see also *Davis-Watkins Co. v. Service Merchandise*, 686 F.2d 1190, 1195 (6th Cir. 1982) (recognizing that manufacturers desire to eliminate free-riding by requiring certain services of its dealers, including, "trained salespersons on the floor to answer [consumer] questions"); *Corrosion Resistant Materials Co. v. Steelite, Inc.*, 692 F. Supp. 407, 408-09 (D.N.J. 1988) (granting summary judgment in favor of a manufacturer that marketed his products through a dual distribution system, one for materials only and one that provided materials and services); *Computer Connection, Inc. v. Apple Computer Corp.*, 621 F. Supp. 569, 570-71 (E.D. La. 1985) (granting summary judgment to a computer manufacturer that terminated a dealer for selling equipment without the use of specially trained sales personnel).

322. See *supra* note 324 and accompanying text.

If the manufacturer considers these point-of-sales services a crucial strategy for interbrand competition, vertical price restraints seem to be the only safeguard available. Not only will vertical price restraints preclude free rider price-discounting, but they also will serve to enhance the quality of point-of-sales services. Because intrabrand price competition is no longer an option, the retailers can compete only with regard to service quality.³²³ The question is whether enhanced point-of-sales services are in the consumers' best interest. The presumption is that they are because they provide information that the consumer values.³²⁴

Assuming that point-of-sales services do provide useful information, it already has been demonstrated that, for the most part, those consumers who benefit the most are those who purchased solely because of the information.³²⁵ In other words, the point-of-sales services do not enhance significantly the well being of those consumers who would have purchased the goods regardless of the availability of information at the store. Because the information costs are included in the product price, all the consumers, those who do not derive any benefit as well as those who do, will pay for the information's availability. As a result, whether consumer welfare is enhanced overall is at best unclear.³²⁶

Even the proposition that point-of-sales services benefits consumers is itself highly questionable. A number of factors raise the suspicion that the services really do not improve the customer's position. The goal of sales personnel clearly is not congruous with the goal of the customer. The salesperson wants to sell more product, not less, and by tapping into consumer ignorance he may induce customers to buy more than they need, or convince them that they are getting more than they actually are. Each retailer also carries a limited number of product lines and a limited number of products within each line. The salesperson has an incentive to convince the unwitting consumer that the products the salesperson has available are exactly what the customer needs, when, in fact, another brand would serve the customer better.

Finally, the marketplace already has provided far superior solutions to product puffing and misinformation. In many product areas, consumer magazines have emerged that test and evaluate products on objective bases, and discuss different needs a consumer might have and how best to fill them. The most widely known is *Consumer Reports*, but there also are specialized publications, such as *PC Magazine* for personal computers, *Runner's World* for running

323. See, e.g., William Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 946 (1987); Easterbrook, *supra* note 4, at 13-14; Hovenkamp, *supra* note 25, at 524.

324. See, e.g., POSNER & EASTERBROOK, *supra* note 323, at 213 (assuming, in discussing the problem of free riders, that "services are valued by consumers").

325. See *supra* notes 316-18 and accompanying text.

326. See Comanor, *supra* note 29, at 991-92; Comanor & Kirkwood, *supra* note 249, at 13. For a critique of the Comanor & Kirkwood article, see Lawrence J. White, *Resale Price Maintenance and the Problem of Marginal and Inframarginal Customers*, 1985 CONTEMP. POL'Y ISSUES 17.

shoes, *Car and Driver* for automobiles, and *Stereo Review* for musical sound systems.³²⁷ Consulting firms also have emerged so that consumers can pose their questions to an unbiased person rather than glean answers from an article. Furthermore, a plethora of manuals have appeared on the market that contain far greater and more accurate information on the use of products than any particular sales person can possess. The increase in toll-free service by manufacturers to support their products is an acknowledgement that, in fact, in-store point-of-sales services is not working satisfactorily.

Thus, the economic justification for protecting vertical price restraints so that they can guard against free riders seems shaky at best. Certainly, providing per se legality seems too risky. At the very least, such conduct should be open to judicial scrutiny, where rule of reason treatment seems eminently appropriate.

VII. *The Rule of Reason—The Middle Road*

To achieve the economically efficient regulation of business activity suggested by the economic analyses in the previous section not only requires abandonment of per se rules, both legal and illegal, but also requires a sophisticated structuring of rule of reason analysis. In other words, specific guidelines must be developed to permit a more refined evaluation of pro- and anticompetitive effects of particular business behavior.

The conventional wisdom is that a rule of reason approach implies that courts must be inundated with extensive empirical data analysis.³²⁸ In the past, such detailed examination of the specifics of particular corporate conduct has entailed that kind of investigation. The problem has been that empirical investigations often take years,³²⁹ are highly inconclusive because of the nature of data analysis itself,³³⁰ and the conclusions reached are very sensitive to nuances of approach.³³¹ Empirical studies, however, are not the only

327. See Levmore, *supra* note 274, at 991 (characterizing such organizations as downstream informers).

328. See, e.g., *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1092 (7th Cir.) (requiring four months of trial to present and analyze empirical data), *cert. denied*, 464 U.S. 891 (1983).

329. From first filing until the date of trial, all parties involved in the *AT&T* case spent six years engaging in empirical studies to support their positions. See *id.*

330. See, e.g., JAN KMENTA, *ELEMENTS OF ECONOMETRICS* 247 (1971).

331. For this reason, courts recently have tried to short circuit this route by increasingly granting summary judgments in favor of defendants based on theoretical economic arguments. See *Resale Price Maintenance Bill Would Help Terminated Dealer To Get \$ 1 Case to Jury*, 58 Antitrust & Trade Reg. Rep. (BNA), No. 1460, at 483 (Apr. 5, 1990). This has not been a proper use of theoretical argumentation, however, because the courts have been resorting in these cases to Chicago School analyses that in effect assert that all corporate conduct is economically efficient. For a discussion of these Chicago School analyses, see *supra* note 28.

means to implement rule of reason analysis. The rule of reason can operate on a more theoretical plane, drawing on economic theory to discover the nature of the market dynamics in antitrust cases.

A theoretical approach is less time consuming and can be more accurate, make more refined distinctions, and be more readily accessible to the courts. Theoretical economic analysis seeks to uncover the core of market dynamics in any given situation while being independent of the particular numbers involved; it looks more to the fundamental structure and operating behavior of the parties and their interactions.

The previous subsections evaluating the impact of vertical restraints all are examples of applications of theoretical economic analyses, an approach that the courts increasingly have been adopting in a wide variety of antitrust areas. Indeed, an extreme example may be found in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,³³² in which the Supreme Court rejected the consideration of empirical data to determine whether defendants engaged in predatory pricing, in favor of abstract theoretical economic arguments that predatory pricing could not exist.³³³ Although extreme, this is not an isolated example.

Movement toward theory will not increase the level of debate among the competing schools of antitrust thought above that which already occurs at the empirical level. Nor will a theoretical approach be any more amenable to particular biases. Guidelines, however, must be structured so that the legal conclusions reached are consistent with the theoretical analysis. For example, economic theory tells us that dealer termination could be due either to free riding activities³³⁴ or to facilitate cartelization pricing.³³⁵ A legal standard must be established to enable the trier of fact to distinguish more precisely between the two possibilities.

Monsanto Co. v. Spray-Rite Service Corp.,³³⁶ for example, provides one such guideline by requiring the jury to focus on whether the manufacturer's termination was an independent act.³³⁷ Such a standard leans toward the view that protection of the manufacturer's market strategy is of paramount importance. Under that view, juries will declare a manufacturer's restraints illegal only when there is no possible basis for the manufacturer's decision other than some form of price cartelization.³³⁸ The *Monsanto* standard does not imply that no trade-off occurs between permitting anticompetitive behavior and invalidating legal behavior. The *Monsanto* Court chose to minimize the circumstances in which legal behavior was condemned

332. 475 U.S. 574 (1986).

333. *Id.* at 595-99; see *supra* notes 231-39 and accompanying text.

334. See *supra* text accompanying notes 310-11.

335. See *supra* note 248 and accompanying text.

336. 465 U.S. 752 (1984).

337. *Id.* at 760-64.

338. See *id.* at 764 (stating that in order for termination to have antitrust consequences "[t]here must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently").

without foreclosing the condemnation of clearly anticompetitive conduct. This legal standard reflects the economic reality that the motivations behind dealer terminations are ambiguous.

Business Electronics Corp. v. Sharp Electronics Corp.,³³⁹ on the other hand, does not provide such a standard. The standard it uses is not based on any economic justifications. It simply, and arbitrarily, selects a factor—agreements as to price levels³⁴⁰—that delineates a group that is not identified with a particular economic result. Indeed, Justice Scalia implicitly acknowledged this when he stated that there is no economic justification for invalidating agreements to terminate price discounters when there is no agreement as to price.³⁴¹ Such an admission recognizes that there is also no economic justification to single out terminations of discounters when there is an agreement as to price.³⁴² Nevertheless, Justice Scalia had no hesitancy in limiting illegal condemnation to a subset of price-discounter terminations, despite the lack of an economic basis for making that distinction. The danger of such arbitrary divisions is that they may prove to be wrong. As already has been demonstrated,³⁴³ the basis for Justice Scalia's differentiation is in fact invalid, because agreements as to specific price levels are not necessary for dealer cartelization to succeed.

Creating new legal standards that are tied to economic insights only can be done in the context of a rule of reason analysis. The *per se* schools on either end of the spectrum lack the necessary flexibility. The Modern Populist School, with its focus on agreements for the purpose of determining whether trade has been restricted unduly, necessarily is forced into making arbitrary choices. Because virtually all business conduct involves some form of agreement, determining which agreements are legal and which are not, absent any economic (or other) theory to make those distinctions, is bound to be discretionary. As a result, cases decided under that approach tend to have random results that appear quite inconsistent.³⁴⁴

The Chicago School, on the other hand, suffers from the other extreme. By relying on the marketplace to resolve most, if not all,

339. 485 U.S. 717 (1988).

340. *Id.* at 735-36.

341. *See id.* at 727.

342. Justice Scalia does argue that cartels are difficult to form and maintain, and that without agreements as to price, cartels would be even more difficult to achieve. *See id.* at 726-27. But this does not seem to justify such sharp distinctions of extremes so that terminations of price discounters in the presence of price agreements are declared *per se* illegal while those without such agreements are not, particularly if they are then rendered *de facto per se* legal. Economic analysis, furthermore, indicates that such sharp distinctions are unwarranted.

343. *See supra* notes 223-25 and accompanying text.

344. *See, e.g.,* *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (stating that mere acquiescence to a price list could constitute vertical price fixing); *United States v. Arnold*

anticompetitive behavior, its position ultimately is limitless. Almost all behavior will, by definition, be market driven and therefore considered procompetitive, whether or not it is procompetitive in fact.

Conclusion

The arguments surrounding vertical price restraints can be seen as part of a larger battle between the Modern Populist School and the Chicago School. The Modern Populist School has as its focus the prevention of monopolistic tendencies of business behavior. The Chicago School, on the other hand, wishes to protect efficient conduct of corporations in pursuit of their competitive activities by limiting government regulation.

In pursuit of their respective goals, each school is drawn to extreme standards—the erection of per se rules. Such per se evaluations do not allow for the legitimate concerns of the opposing school. In addition, by advocating maximum protection against their respective perceived evils, each school's approach leaves society subject to the very problems sought to be avoided. Thus, the Modern Populists, by erecting per se rules to stop monopolization, actually create impediments to corporate attempts to foster healthy competition. The Chicago School, by advocating per se legality to protect corporate efficiency, puts the nation at risk of unreasonable restraints of trade. Clearly, any articulated standard successfully will protect against one evil in some cases and in others will permit the occurrence of another evil. The question is what trade-off between the two competing harms should be made. Both the Modern Populist School and the Chicago School are guilty of not permitting any trade-off, hence their tendency towards per se rules. The only framework that permits the weighing and balancing of competing concerns is the rule of reason. Furthermore, the rule of reason can facilitate minimizing the extent of trade-off necessary, by permitting the courts to tailor their judgments to the specific circumstances. Those scholars who advocate the application of the rule of reason to all vertical restraints, including those involving price, are correct that such an approach will maximize society's efficiency while minimizing the risk of antitrust harm. Their interpretation that *Business Electronics Corp. v. Sharp Electronics Corp.*³⁴⁵ continues the expansion of the rule of reason begun by *Continental T.V., Inc. v. GTE Sylvania Inc.*³⁴⁶ and *Monsanto Co. v. Spray-Rite Service Co.*³⁴⁷ may, however, be erroneous. Those commentators who object to the use of the rule of reason for vertical price restraints and want to maintain per se illegal treatment have good reason to be alarmed, because *Sharp*

Schwinn & Co., 388 U.S. 365 (1967) (applying Modern Populist standard of per se illegality); *White Motor Co. v. United States*, 372 U.S. 253 (1963) (recognizing that non-price restraints might have strong procompetitive effects but ultimately remanding for trial).

345. 485 U.S. 717 (1988).

346. 433 U.S. 36 (1977).

347. 465 U.S. 752 (1984).

may have set the stage for vertical price restraints to escape antitrust scrutiny altogether.

POSTSCRIPT

Alarmed by the barriers erected by *Sharp* to vertical price fixing litigation, particularly when coupled with the confusing evidentiary standards suggested by *Monsanto*, each house of Congress has acted to curtail the effects of these decisions.³⁴⁸ Although each house's bill purports to have the common goal of overruling *Sharp* and *Monsanto*,³⁴⁹ close examination of the bills reveals that the struggle between preserving populist concepts of competition on the one hand and protecting efficient business conduct on the other extends to the legislative branch. Moreover, though one might infer that an intent to overrule *Sharp* and *Monsanto* would indicate a return to the stricter standards of per se illegality advocated by the Populist School, the two chambers instead have chosen to advance the reach of the rule of reason to extend to vertical relationships.

As might be expected, both bills overrule *Sharp*'s requirement that there be agreements on price levels for concerted action to constitute vertical price fixing.³⁵⁰ But both bills seek what neither *Sharp* nor *Monsanto* dared to suggest and *ARCO* only hinted at—to take vertical maximum price fixing out of the per se category and evaluate it instead under the rule of reason. The Senate version does so explicitly,³⁵¹ and the House version, by creating an exception for maximum price setting,³⁵² does so implicitly.

Consistent with their expressed goals, the two bills soften *Monsanto*'s requirement that "the possibility of independent action" be excluded before a vertical price fixing agreement could be found.³⁵³ A philosophical difference between the chambers is evident in the standards each imposes instead. The Senate bill, requiring that the retailer's price discounting be the major cause for its termination before the termination can be found to be illegal,³⁵⁴ reflects a modern market approach. This approach protects any nonprice motivations that may be behind the manufacturer's conduct. The House bill merely requires that the manufacturer's termination be "in response" to another dealer's complaint.³⁵⁵ This approach indicates

348. S. 429, 102d Cong., 1st Sess. (1991); H.R. 1470, 102d Cong., 1st Sess. (1991).

349. S. REP. NO. 102-42, 102d Cong., 1st Sess., 18-20 (1991) [hereinafter *SENATE REPORT*]; H.R. REP. NO. 102-237, 102d Cong., 1st Sess., 1-2 (1991) [hereinafter *HOUSE REPORT*].

350. S. 429 § 39(b); H.R. 1470 § 2(b).

351. S. 429 § 3(b).

352. H.R. 1470 § 2(b).

353. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984).

354. S. 429 § 3(a)(1)(B)(ii).

355. H.R. 1470 § 2(a)(2).

sympathy for the Modern Populist School's emphasis on deterring possible interference with the market pricing mechanism. In spite of these differences, however, the committee reports to both bills make it clear that both bills intend to preserve the manufacturer's independent efficient conduct, which requires market evaluation. Their disagreement primarily lies in the extent to which they are willing to risk the possibility that some vertical price fixing will fall beyond the reach of the antitrust laws.

Thus, though the battle between preserving certain market structures and protecting efficient corporate activity continues, it appears that the inevitable resolution is down the road to the rule of reason.

*Appendix*³⁵⁶

<i>Case</i>	<i>Disposition</i>
J.F. Feeser, Inc. v. Serv-A-Portion, Inc., 909 F.2d 1524 (3d Cir. 1990), <i>cert. denied</i> , 111 S. Ct. 1313 (1991).	Summary Judgment for Defendant Vacated.
DeLong Equip. Co. v. Washington Mills Abrasive Co., 887 F.2d 1499 (11th Cir. 1989), <i>cert. denied</i> , 110 S. Ct. 1813 (1990).	Summary Judgment for Defendant Reversed.
International Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904 (6th Cir. 1989), <i>cert. denied</i> , 110 S. Ct. 1783 (1990).	Summary Judgment for Defendant Affirmed.
H.L. Hayden Co. v. Siemens Medical Sys., 879 F.2d 1005 (2d Cir. 1989).	Summary Judgment for Defendant Affirmed.
Crane & Shovel Sales Corp. v. Bucyrus-Erie Co., 854 F.2d 802 (6th Cir. 1988).	Dismissal for Failure to State a Claim Affirmed.
Dreiling v. Peugeot Motors of Am., 850 F.2d 1373 (10th Cir. 1988).	Summary Judgment for Defendant Affirmed.
Jeanery, Inc. v. James Jeans, Inc., 849 F.2d 1148 (9th Cir. 1988).	JNOV for Defendant Affirmed.
Isaksen v. Vermont Castings, Inc., 825 F.2d 1158 (7th Cir. 1987), <i>cert. denied</i> , 486 U.S. 1005 (1988).	JNOV for Defendant Reversed.
Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc., 824 F.2d 582 (8th Cir. 1987), <i>cert. denied</i> , 484 U.S. 1010 (1988).	Summary Judgment for Defendant Affirmed.
Valley Liquors, Inc. v. Renfield Importers, Ltd., 822 F.2d 656 (7th Cir.), <i>cert. denied</i> , 484 U.S. 977 (1987).	Summary Judgment for Defendant Affirmed.

356. This list corresponds with the discussion *supra* note 37 and accompanying text. This list was compiled through a LEXIS search conducted in September 1991. The search terms used were: "ANTITRUST" and "VERTICAL RESTRAINTS" and "PER SE" and "DEALER" or "DISTRIBUTOR" w/5 "TERMINATION" and 199* or 198* or 197*. The search retrieved 42 cases. Four cases were excluded because they were decided prior to the Supreme Court's decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). *Spray-Rite Service Corp. v. Monsanto Co.*, 684 F.2d 1226 (7th Cir. 1982), *aff'd*, 465 U.S. 752 (1984), was excluded because of its ascension to the Supreme Court. The remaining seven cases were excluded because they were not dealer termination cases.

Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216 (10th Cir. 1986), <i>cert. denied</i> , 486 U.S. 1005 (1988).	Judgment for Plaintiff Reversed and Judgment for Defendant Ordered.
Business Elecs. Corp. v. Sharp Elecs. Corp., 780 F.2d 1212 (5th Cir. 1986), <i>aff'd</i> , 485 U.S. 717 (1988).	Judgment for Plaintiff Reversed.
Jayco Sys. v. Savin Business Machs. Corp., 777 F.2d 306 (5th Cir. 1985), <i>cert. denied</i> , 479 U.S. 816 (1986).	Summary Judgment for Defendant Affirmed.
Tunis Bros. v. Ford Motor Co., 763 F.2d 1482 (3d Cir. 1985), <i>vacated and remanded for further consideration in light of Matsushita Elec. Indus. v. Zenith Radio Corp.</i> , 475 U.S. 574 (1986), 475 U.S. 1105 (1986).	Summary Judgment for Defendant Reversed.
Zidell Explorations, Inc. v. Conval Int'l, 719 F.2d 1465 (9th Cir. 1983).	Judgment for Plaintiff Reversed.
Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560 (11th Cir. 1983).	Judgment for Plaintiff Affirmed.
Hornsby Oil Co. v. Champion Spark Plug Co., 714 F.2d 1384 (5th Cir. 1983).	Judgment for Plaintiff Reversed.
JBL Enters. v. Jhirmack Enters., 698 F.2d 1011 (9th Cir.), <i>cert. denied</i> , 464 U.S. 829 (1983).	Summary Judgment for Defendant Affirmed.
Continental T.V., Inc. v. GTE Sylvania Inc., 694 F.2d 1132 (9th Cir. 1982).	Judgment for Defendant Affirmed.
Carlson Mach. Tools, Inc. v. American Tool, Inc., 678 F.2d 1253 (5th Cir. 1982).	Summary Judgment for Defendant Affirmed.
Sports Ctr., Inc. v. Riddell, Inc., 673 F.2d 786 (5th Cir. 1982).	Judgment for Defendant Affirmed.
Battle v. Lubrizol Corp., 673 F.2d 984 (8th Cir. 1982).	Summary Judgment for Defendant Reversed.
Blankenship v. Herzfeld, 661 F.2d 840 (10th Cir. 1981).	Judgment for Defendant Supplier Affirmed, Judgment for Competing Dealers Reversed.
Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981).	Judgment for Plaintiff Reversed.
Ron Tonkin Gran Turismo, Inc. v. Fiat Distribs., Inc., 637 F.2d 1376 (9th Cir.), <i>cert. denied</i> , 454 U.S. 831 (1981).	Summary Judgment for Defendant Affirmed.

Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir.), *cert. denied*, 454 U.S. 827 (1981).

Contractor Util. Sales Co. v. Certain-Teed Prods. Corp., 638 F.2d 1061 (7th Cir. 1981).

Cowley v. Braden Indus., 613 F.2d 751 (9th Cir.), *cert. denied*, 446 U.S. 965 (1980).

Oreck Corp. v. Whirlpool Corp., 579 F.2d 126 (2d Cir. 1978).

Knutson v. Daily Review, Inc., 548 F.2d 795 (9th Cir. 1976), *cert. denied*, 433 U.S. 910 (1977).

JNOV for Defendant Affirmed.

Directed Verdict for Defendant Affirmed.

Judgment for Defendant Affirmed.

Judgment for Plaintiff Reversed.

Judgment for Plaintiff Reversed.