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Business Electronics Corp. v. Sharp Electronics Corp.: Monstano's Progeny and the Congressional Proposal to Codify the Per Se Rule against Vertical Price Fixing

Dennis O. Doherty

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Antitrust laws protect competition, not competitors. Protection of vigorous price competition as a means of promoting consumer welfare and economic efficiency has always been at the heart of this maxim. Section 1 of the Sherman Antitrust Act proscribes attempts to unreasonably interfere with the free-market forces that determine prices. In 1911, the United States Supreme Court first established that vertical price fixing was just such an unreasonable restraint of trade. Although Congress permitted a "fair trade" exemption to the Sherman Act for a time, in the ensuing seventy-eight years the Court reaffirmed the per se proscription against vertical price fixing in every case in which the issue arose. Recently, however, the executive and judicial branches of the Federal Government have challenged this absolute proscription against vertical price fixing as potentially creating market imperfections and discouraging efficient economic behavior.

Theorists from the "Chicago School" of antitrust law propounded an

2. Recognizing that the primary purpose of antitrust law is the promotion of consumer welfare, the United States Supreme Court has called the Sherman Antitrust Act a "consumer welfare prescription." NCAA v. Board of Regents, 468 U.S. 85, 107 (1984) (quoting Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979)).
3. Sherman Antitrust Act of July 2, 1890, ch. 647, 26 Stat. 209 (current version at 15 U.S.C. §§ 1-7 (1982)). Section 1 prohibits "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States or with foreign nations." Id. § 1.
4. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). The Court did not actually use the phrase "illegal per se" in Dr. Miles. One of the first cases to hold that price fixing was illegal per se was United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940).
5. See infra notes 85-89 and accompanying text.
7. See infra text accompanying notes 101-49.
“efficiency” theory that urges the elimination of the per se rule because vertical price fixing may promote efficiency and competition. The Chicago School conflicts with traditional antitrust theory, which supports per se prohibitions against vertical price fixing and advocates the view that reasonable and vigorous price competition is more economically efficient and beneficial. The Chicago School’s efficiency theory, however, has gained acceptance in modern legal circles and has created a movement to overturn the precedent establishing vertical price fixing as illegal per se.

The efficiency theories of the Chicago School gained powerful proponents in the Reagan administration. Despite empirical studies indicating the adverse economic effects of vertical price fixing, the Reagan administration

8. See generally Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 YALE L.J. 373 (1966). Under this theory, increases in output promote efficiency and competition. Id. at 403-05. Price restraints imposed on a distributor by a manufacturer promote efficiency and competition because the manufacturer’s goal is to increase output, not prices. Id. Manufacturers would not want to impose price restraints unless they were output enhancing. Id. Therefore, vertical price restraints are procompetitive and efficient. The manufacturer establishes a price or price level that induces a distributor to provide customer services, such as advertising, promotion, repair, and credit services, that the manufacturer has determined the customer wants, and that will persuade more customers to purchase the product. Id. at 429, 453-61. If the convenience that the customer realizes from these services more than offsets the utility the customer loses from the increase in the product’s price, demand and output rise. If the utility from the services is less, the manufacturer adjusts the price and/or the level and quality of services to maintain output. Id. at 473; see also R. BORK, THE ANTITRUST PARADOX (1978); Baxter, Vertical Restraints and Resale Price Maintenance: A ‘Rule-of-Reason’ Approach, 14 ANTITRUST L. & ECON. REV. 13 (Issue 4, 1982); Posner, The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality, 48 U. CHI. L. REV. 6 (1981).

9. This school is also sometimes called the “consumer welfare” school after the theories developed by former Judge Robert Bork in his book The Antitrust Paradox. See R. BORK, supra note 8. As one commentator has noted, this terminology is misleading because the effect of these policies may actually result in the transfer of wealth from the consumer to the retailers and manufacturers, leaving the consumer economically disadvantaged. See Gerla, infra note 98, at 3 n.10; see also H. HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW § 2.3 (1985).

10. H. HOVENKAMP, supra note 9, at § 1.1. The traditional study of economics teaches that businesses unable to compete on a price basis succumb to more efficient rivals. Id. The consumer benefits from lower prices and higher quality products; the manufacturer realizes economies of scale and higher profits from increased output; and the economy benefits from a more efficient allocation of economic resources. Id. Section 1 of the Sherman Antitrust Act and antitrust laws in general are designed to protect against contracts, combinations, or conspiracies in restraint of trade formed for the purpose and with the effect of frustrating this result. See Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 4-5 (1958).


12. See, e.g., ANTITRUST DIVISION, UNITED STATES DEPARTMENT OF JUSTICE, VERTICAL RESTRAINTS GUIDELINES (1985) [hereinafter GUIDELINES]; see also infra text accompanying notes 119-31.

used the efficiency theory to defend its attempt to overturn the absolute proscription against this type of conduct.\textsuperscript{14} Two developments evidenced the administration's effort to eliminate or limit the application of the per se standard. First, the United States Department of Justice (DOJ) established a policy to intervene on behalf of defendants in private vertical price fixing actions.\textsuperscript{15} Second, the DOJ effectively abdicated responsibility for government enforcement of the vertical price fixing laws\textsuperscript{16} by ignoring or distinguishing the per se rule.\textsuperscript{17}

The judiciary's view of vertical restraints also took on a decidedly Chicago School flavor. The Supreme Court's decision in \textit{Continental T.V., Inc. v. GTE Sylvania, Inc.},\textsuperscript{18} which applied the rule of reason to vertical nonprice restraints, evidenced the efficiency theory's impact on the legal treatment of vertical restraints.\textsuperscript{19} Seven years later, in \textit{Monsanto Co. v. Spray-Rite Service Corp.},\textsuperscript{20} the Court relied on the efficiency rationale enunciated in \textit{Sylvania}\textsuperscript{21} that the prices of goods were 18 to 27 percent higher under the fair trade laws and that consumers could save $1.2 billion a year, $2.1 billion adjusted for inflation, by eliminating the fair trade laws; Brief Amicus Curiae of Dayton Hudson Corp. for Petitioner at 14-17, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) (No. 82-914) (citing studies showing resale price maintenance's pernicious effect on prices, innovation and new businesses); see also Retail Competition Enforcement Act, 1987: Hearings on S. 430, A Bill to Amend the Sherman Act Regarding Retail Competition, Before the Committee on the Judiciary, United States Senate, 100th Cong., 1st Sess. 105 (1987) (statement of Mr. Monroe G. Milstein, President of the Burlington Coat Factory Warehouse Corp., citing a 1975 Justice Department study) [hereinafter Hearings]; id. at 69.

14. See, e.g., Brief for the United States as Amicus Curiae in Support of Petitioner, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) (No. 82-914) (hereinafter Brief); GUIDELINES, supra note 12; see also infra notes 128-31 and accompanying text.


16. S. REP. No. 280, 100th Cong., 2nd Sess. 2 (1987). The existence of this policy is evidenced by the fact that the United States Department of Justice (DOJ) had not brought a single vertical price fixing action since 1981. \textit{Id.}

17. \textit{Id.} at 4-5.


21. \textit{Sylvania}, 433 U.S. at 54-56. The Court also based its holding on the views advocated by the DOJ in an amicus brief filed on behalf of Monsanto. See Brief, supra note 14. The amicus brief advocated the elimination of the per se standard for vertical price fixing as inconsistent with the Court's decision in \textit{Sylvania} and the requirement of proof of an explicit agree-
to narrow the breadth of the absolute prohibition against vertical price fixing by imposing a greater burden of proof on plaintiffs.\textsuperscript{22} This new evidentiary standard raised questions about the quantum of proof needed to prove a violation of the rule against vertical price fixing and consequently created confusion in the lower courts.\textsuperscript{23} Four years later, \textit{Business Electronics Corp. v. Sharp Electronics Corp.}\textsuperscript{24} answered the question as to what quantum of evidence satisfied the \textit{Monsanto} evidentiary standard.

Sharp Electronics Corporation (Sharp), a manufacturer of electronic products, granted Business Electronics Corporation (BEC), a discount retailer of electronic products, the sole Sharp dealership in the Houston area in 1968.\textsuperscript{25} After disagreements between Sharp and BEC over sales quotas and discounting, Sharp granted a second dealership in the Houston area to Hartwell.\textsuperscript{26} Upset about BEC's discounting and alleged "free riding"\textsuperscript{27} practices, Hartwell approached BEC in an effort to convince BEC to end these practices and also complained to Sharp.\textsuperscript{28} With no resolution forthcoming, Hartwell presented an ultimatum to Sharp in June 1973 threatening to end their relationship unless Sharp terminated BEC.\textsuperscript{29} Sharp did so,\textsuperscript{30} and BEC brought suit alleging that Sharp and Hartwell had conspired to terminate BEC in violation of section 1 of the Sherman Act.\textsuperscript{31}

Sharp contended that it terminated BEC because of poor sales performance.\textsuperscript{32} BEC countered that its termination resulted from an agreement be-

\textsuperscript{24} 108 S. Ct. 1515 (1988).
\textsuperscript{26} \textit{Id.} at 1215.
\textsuperscript{27} \textit{See infra} note 228.
\textsuperscript{28} 780 F.2d at 1215.
\textsuperscript{29} \textit{Id.}
\textsuperscript{30} \textit{Id.}
\textsuperscript{31} \textit{Id.} at 1214.
\textsuperscript{32} \textit{Id.} at 1215.
between Sharp and Hartwell to eliminate price competition. The case went to the jury with instructions that BEC's termination would violate section 1 of the Sherman Act if Sharp and Hartwell had agreed to terminate BEC because of its price cutting policy. The jury found in favor of BEC.

On appeal, the United States Court of Appeals for the Fifth Circuit reversed and remanded. The Fifth Circuit found error in the trial court's jury instruction that a finding of an agreement between Sharp and Hartwell to terminate BEC for its price cutting established a per se violation of the Sherman Act. Holding that a manufacturer's termination of a dealer would be per se illegal only if effected pursuant to a price maintenance agreement with another dealer, the court of appeals concluded that the evidence might be sufficient to find that Sharp terminated BEC pursuant to such a price agreement, and remanded the case for further proceedings consistent with its opinion. However, in a short concurring opinion, one of the circuit judges invited the United States Supreme Court to address the confusing and uncertain area of vertical restraints. When BEC appealed, the Supreme Court granted certiorari.

The Supreme Court affirmed the Fifth Circuit's decision, holding that a vertical restraint of trade was not a per se violation under section 1 of the Sherman Act unless it included an agreement on prices or price levels. Writing for the majority, Justice Scalia reasoned that vertical restraints may promote economic efficiency and competition, and concluded that economic analysis supported the view that the appropriate standard for non-price restraints was the rule of reason. The Court again used the theoretical efficiencies and procompetitive benefits of vertical restraints to narrow the absolute prohibition against vertical price fixing. The Court would not

33. Id. Evidence indicated that Hartwell usually complied with Sharp's suggested resale price list, and that both Hartwell and Sharp had attempted to obtain compliance with the price list from Business Electronics Corporation (BEC). Id. at 1219. In addition, BEC presented evidence that it was not "free riding," that its sales performance was equal to Hartwell's, and that BEC's termination was in response to Hartwell's complaints and ultimatum. Id.
34. Id. at 1215.
35. Id. at 1214.
36. Id. at 1220.
37. Id. at 1215.
38. Id. at 1218.
39. Id. at 1219-20.
40. Id. at 1221-22.
43. Id. at 1519-20.
44. Id. at 1517, 1525.
45. Id. at 1519-20.
permit a jury to infer a vertical price fixing agreement merely from a dealer's termination following the complaints of a competing dealer.\textsuperscript{46} Instead, the Court held that the plaintiff must present sufficient direct or circumstantial evidence to prove the existence of an explicit price agreement between the manufacturer and the complaining dealer.\textsuperscript{47}

Justice Stevens, writing in dissent, objected to the majority's mischaracterization of the restraint as a nonprice restraint.\textsuperscript{48} He noted that the majority's decision attached more weight to the mere theoretical possibilities of economic and competitive benefits than to the real economic impact of this restraint on price competition.\textsuperscript{49} Justice Stevens contended that such dealer terminations were more appropriately characterized as boycotts and, therefore, naked price-based restraints of trade in violation of the Sherman Antitrust Act.\textsuperscript{50}

Congress has reacted vigorously to the challenge to the per se rule and has taken various actions to prevent the erosion of the absolute prohibitions against vertical price fixing.\textsuperscript{51} Nevertheless, executive and judicial efforts to overturn or weaken the per se protections against vertical price fixing have succeeded.

This Note examines the development of antitrust law with respect to vertical restraints and the conflict between the judicial, executive, and legislative branches over the per se prohibition against vertical price fixing. It emphasizes the Supreme Court cases narrowing the per se standard applicable to vertical price restraints. Next, the Note focuses on the Justice Department's efforts to undermine private vertical price fixing actions and its failure to enforce the prohibitions against vertical price fixing under the Sherman Act. Against this background, the Note discusses the \textit{Sharp} decision and its contribution to the gradual demise of the per se standard. The Note then critically analyzes the procompetitive and efficiency-enhancing benefits of vertical price fixing that the DOJ and the Supreme Court have advocated as a basis for narrowing or eliminating the per se standard. It then attempts to project the legal and economic impact of the \textit{Sharp} decision. The Note reviews the actions that Congress is considering to turn back the assault on the per se standard. Finally, the Note concludes that Congress must codify the

\textsuperscript{46} \textit{Id.} at 1520-21.

\textsuperscript{47} \textit{Id.}

\textsuperscript{48} \textit{Id.} at 1526 (Stevens, J., dissenting).

\textsuperscript{49} \textit{Id.} at 1536.

\textsuperscript{50} \textit{Id.} at 1531-32. Justice Stevens characterized the restraint as a horizontal restraint of trade; that is, a restraint of trade at the same level in the distribution system rather than a vertical restraint, which affects different levels in the distribution system. \textit{Id.} at 1526; \textit{see infra} note 54.

\textsuperscript{51} \textit{See infra} text accompanying notes 156-72.
per se prohibition against vertical price fixing and restore the plaintiff's right to a jury trial where the plaintiff presents evidence sufficient to infer a price fixing conspiracy.

I. **FUNDAMENTAL ISSUES IN THE VERTICAL RESTRAINTS CONTROVERSY**

Every contract and every business relationship involves a restraint of trade. The Supreme Court has construed the Sherman Act, however, as proscribing only unreasonable restraints of trade. Restraints of trade are classified as either horizontal or vertical. Vertical restraints, both price and nonprice, primarily affect intrabrand competition which is defined as competition among sellers of the same manufacturer's product. Vertical price restraints, commonly known as resale price maintenance agreements,

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52. Board of Trade of Chicago v. United States, 246 U.S. 231, 238 (1918).
53. *Id.* The Sherman Antitrust Act states that "(e)very contract, combination . . . is hereby declared to be illegal," and indeed, in early judicial interpretations of the Act, the proscription was literally construed to include what are today considered reasonable restraints. See United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897), overruled sub nom. Standard Oil Co. v. United States, 221 U.S. 1 (1911). In United States v. Trenton Potteries Co., 273 U.S. 392 (1927), the Court recognized the reasonableness standard for restraints of trade:

> The essence of the law is injury to the public. It is not every restraint of competition and not every restraint of trade that works an injury to the public; it is only an undue and unreasonable restraint of trade that has such an effect and is deemed to be unlawful.

*Id.* at 395. (emphasis added).

54. **ANTITRUST SECTION, AMERICAN BAR ASS'N, ANTITRUST LAW DEVELOPMENTS** 28-55 (2d ed. 1984) [hereinafter DEVELOPMENTS]. A horizontal restraint is an agreement, either express or implied, among competitors of the same or similar product at the same level in the production-distribution system that affects the competitive relationship of the parties. *Id.* It may include, for example, an agreement as to prices, product, territories, or services. *Id.* Among the practices that have been deemed illegal per se are price fixing, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); cornering the market in a product, *id.* at 150; group boycotts, Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); division of markets, United States v. Topco Assoc., Inc., 405 U.S. 596 (1972); and fixing uniform customer discounts or credit terms, Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980). This Note will deal exclusively with vertical restraints.

55. **H. HOVENKAMP, supra** note 9, § 9.1. Vertical restraints are agreements between manufacturers and their dealers that restrict the freedom of dealers to market the product. *Id.* Typical vertical restrictions imposed on the dealer include resale price maintenance (vertical price fixing), location and customer restrictions, and exclusive dealing and tying arrangements. *Id.* §§ 8.1, 9.1; see also DEVELOPMENTS, supra note 54, at 55-108. Among the vertical practices that have been deemed to be illegal per se are vertical price fixing, Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911); and tying arrangements, International Salt Co. v. United States, 332 U.S. 392 (1947).

56. **See supra** note 55. In contrast, horizontal restraints affect interbrand competition: competition among the sellers of the same or similar product of different manufacturers. **See supra** note 54.
are agreements between manufacturers and dealers to fix the prices at which the dealer will resell the manufacturer's product.\textsuperscript{57} Manufacturers impose vertical nonprice restraints to control the marketing and sale of the product.\textsuperscript{58} Under current law, vertical restraints are subject to one of two standards: a per se rule or the rule of reason.

A per se rule of illegality is generally a conclusive presumption that a restraint is unreasonable.\textsuperscript{59} Courts apply the standard to conduct deemed to have a "pernicious" effect on competition,\textsuperscript{60} that is, conduct that "almost always results in adverse competitive effects, and almost never is justified by business reasons."\textsuperscript{61} The use of "almost" implies that the conduct may have procompetitive effects, but that collateral anticompetitive effects almost always outweigh these effects. The rationale for applying a per se rule is that it provides a "bright line" standard for the business and legal communities and results in administrative efficiency by deeming certain conduct illegal per se without proof of actual anticompetitive effects or injury.\textsuperscript{62}

A rule of reason standard, on the other hand, recognizes that certain restrictive conduct may promote economic efficiency or competition and attempts to balance these benefits against the potential anticompetitive effects of the conduct in order to determine whether the conduct is unreasonable.\textsuperscript{63}

The test, articulated by Justice Brandeis in \textit{Board of Trade of Chicago v.}

\textsuperscript{57} 7 P. AREEDA, ANTITRUST LAW, ¶1437 (1986).
\textsuperscript{58} See supra note 55. Territorial and customer restrictions, exclusive dealership arrangements, and tying arrangements are the most common types of vertical nonprice restraints. \textit{Id.}
\textsuperscript{59} Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 344 (1982).
\textsuperscript{60} Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958). The Court defined those practices to which a per se standard should apply. The Court stated: [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of \textit{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 into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken. \textit{Id.}; see also United States v. Container Corp. of America, 393 U.S. 333, 341 (1969) (Marshall, J., dissenting) (defining the rationale of the per se standard).
\textsuperscript{62} See Maricopa County, 457 U.S. at 343-44. Antitrust litigation is extremely complex, expensive, and time-consuming. \textit{Id.} Judicial and business efficiencies are realized by avoiding the long, complex, and expensive trials required in rule of reason actions. \textit{Id.} Thus, when a per se rule is applied, the judicial system and the business environment benefit from a relatively clear and concise statement of the conduct proscribed by the Sherman Act. \textit{Id.}
\textsuperscript{63} Board of Trade of Chicago v. United States, 246 U.S. 231, 238 (1918).
United States,\(^64\) requires a determination of whether the restraint merely regulates and thereby promotes competition, or whether it suppresses or destroys competition.\(^65\) The typical rule of reason case requires a complex and time-consuming examination of the specific conduct, the product and geographic markets, the adverse and beneficial impact of this conduct on those markets, and the motives and justifications for the conduct.\(^66\) Restraints that are not illegal per se are subjected to the rule of reason standard. A rule of reason action can be an extremely expensive process and is often difficult for a plaintiff to win. A per se standard avoids this costly fact-finding process because it requires proof only of the existence of the conduct.

II. DEVELOPMENT OF VERTICAL RESTRICIONS LAW

A. Vertical Price Restraints and the Sherman Act

In 1911, the Supreme Court established the illegality of vertical price fixing in Dr. Miles Medical Co. v. John D. Park & Sons Co.\(^67\) Dr. Miles, a manufacturer of proprietary medicines, required each wholesale and retail seller of its products to enter into a consignment or agency contract that fixed the prices at which the dealer could resell Dr. Miles' products.\(^68\) Dr. Miles alleged that the defendant, a wholesaler, had obtained the company's products from Dr. Miles' agents and had sold them at less than the contractually set minimum prices.\(^69\) Noting that agreements having no other purpose than to restrain competition and fix prices were injurious to the public,\(^70\) the Court held the plaintiff's consignment contract invalid both at common law and under the Sherman Act.\(^71\)

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\(^64\) 246 U.S. 231 (1918).
\(^65\) Id. at 238. Justice Brandeis described the test as follows:
The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id.; see also National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 687-92 (1978) (providing a history and explanation of the rule of reason standard).

\(^66\) See Pitofsky, supra note 61, at 13.
\(^67\) 220 U.S. 373 (1911).
\(^68\) Id. at 394.
\(^69\) Id. at 382.
\(^70\) Id. at 408.
\(^71\) Id. at 409. Later decisions established that an explicit agreement was not required. An agreement may be inferred from a course of dealing, conduct, or other circumstances, or by acquiescence. See United States v. Parke, Davis and Co., 362 U.S. 29, 43-44 (1960); United
Recognizing that the Sherman Act did not take away the manufacturer's right to choose with whom it would conduct business, the Court soon narrowed the scope of the *Dr. Miles* decision. In *United States v. Colgate & Co.*, the Court literally construed the Sherman Act's prohibition against contracts and combinations in restraint of trade. Colgate published a price list and urged dealers to conform to these prices. In addition, Colgate announced that it would refuse to deal with any wholesalers or retailers that would not agree to maintain these prices.

Interpreting the proscriptions of the Sherman Act as reaching only contracts or combinations in restraint of trade, the Court held that a unilateral refusal to deal did not violate the Sherman Act. The Court stated that, in the absence of an attempt to create a monopoly, the Sherman Act did not restrict the manufacturer's right to choose the parties with whom it would deal. In addition, the manufacturer could announce in advance its pricing policy and those circumstances under which it would refuse to deal.

Although the *Colgate* principle recognized the manufacturer's right to unilaterally refuse to deal with a customer, the Court soon limited this principle. Three years later, in *FTC v. Beech-Nut Packing Co.*, the manufacturer not only promulgated its pricing policy and announced its intention to refuse to deal with noncomplying dealers, but also established a system to enforce these pricing policies. Beech-Nut solicited assurances from its dealers that they would maintain a certain price level and used these dealers to police other dealers in order to ensure compliance with its pricing policies. Dealers violating Beech-Nut's pricing policies or selling to noncomplying dealers were terminated and boycotted. Beech-Nut would reinstate terminated dealers if they provided assurances of future compliance with Beech-Nut's pricing policies.

The Court concluded that these methods went beyond the manufacturer's
right to refuse to deal enunciated in Colgate. The Court held that Beech-Nut's enforcement system and the required dealer assurances of cooperation constituted a restraint of competition and unfair trade practice in violation of section 5 of the Federal Trade Commission Act.

While the courts generally continued to enforce the per se rule against vertical price fixing in the period after Beech-Nut, state pressure on Congress to permit a "fair trade" exemption from the Sherman Act and a growing number of judicial decisions upholding state fair trade laws prompted Congress to grant a fair trade exemption in 1937. Growing discontent with the economic consequences of the state fair trade exemption caused Congress

83. Id. at 454.
85. See E. KINTNER, 2 FEDERAL ANTITRUST LAWS § 10.16 (1980). In 1937, the year of passage of the federal fair trade exemption, 37 states had enacted fair trade laws and six other states had proposed them. See also infra notes 87-88.
86. See Old Dearborn Distrib. Co. v. Seagram-Distillers Corp., 299 U.S. 183 (1936) (upholding the constitutionality of Illinois' Fair Trade Act); Pep Boys, Manny, Moe & Jack, Inc. v. Pyrilo Sales Co., 299 U.S. 198 (1936) (upholding the constitutionality of California's Fair Trade Act). State fair trade laws permitted manufacturers to control resale prices through vertical price fixing. Fair trade laws in California and Illinois were upheld by the Supreme Court in 1936. Id. at 201; Old Dearborn, 299 U.S. at 191-98.
88. Id. Vertical price fixing in all contexts remained illegal per se until Congress passed the Miller-Tydings Act in 1937, amending the Sherman Act. Id. The Miller-Tydings Act permitted manufacturers to prescribe minimum prices for the intrastate resale of products bearing the "trademark, brand or name of the producer or distributor of such commodity" if such practice was lawful under state statute, common law or public policy. Id. The McGuire Act of 1952 expanded the power of the manufacturer to set minimum prices by binding non-parties to the resale price maintenance (RPM) contracts or agreements. Act of July 14, 1952, ch. 745, 66 Stat. 631, 632, repealed by Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. Thus, if one dealer in a state had entered into an RPM agreement with a manufacturer, then all other dealers in that manufacturer's product in the state were required to abide by the minimum prices. Id.

Both of these acts required "free and open competition with commodities of the same general class" in order for the manufacturer to be eligible for the exemption from the Sherman Act. Ch. 690, 50 Stat. at 693. The free and open competition requirement, however, in no way assured the consumer the benefits of vigorous price competition. One study, conducted by the Justice Department under President Nixon and cited in a 1969 Economic Report of the President, found that these fair trade practices increased the price of products by 18 to 27 percent. S. REP. NO. 280, supra note 16, at 2. Another study determined that if these acts were repealed, consumers would save approximately $1.2 billion. Id. For these and other reasons, the number of states permitting resale price maintenance declined from a peak of 46 to 12 in 1975.
Following the enactment of the fair trade exemption, the Court continued its assault on the Colgate principle by further limiting the types of actions that the Court deemed unilateral. In *United States v. Bausch & Lomb Optical Co.* and *United States v. Parke, Davis & Co.*, the Court reiterated its position on manufacturers' actions designed to enforce resale price systems. At issue in both cases was a system of prices and price enforcement similar to Beech-Nut's system.

As in Beech-Nut, the Court in Bausch & Lomb and Parke, Davis stressed the coercive and conspiratorial nature of the pricing system. The pricing policies in dispute went beyond mere unilateral refusals to deal or dealer acquiescence to the pricing systems. In each case, the Court found that the distributor and licensed dealers conspired to fix resale prices and limit sales, and held that the cooperative enforcement of the price system and boycotts of noncomplying dealers constituted a combination in restraint of trade in violation of the Sherman Act.

While affirming the Colgate principle of unilateral action in Beech-Nut, Bausch & Lomb, and Parke, Davis, the Court substantially limited Colgate's application, thereby restricting a manufacturer's ability to police and enforce.


90. 321 U.S. 707 (1944). Bausch & Lomb's sole distributor, Soft-Lite, had a dual licensing system. *Id.* at 714-17. Wholesalers were licensed to sell pink-tinted eyeglass lenses at a fixed price to licensed retailers, and retailers were licensed to sell the lenses at locally prevailing prices to the public. *Id.* Pursuant to the licensing agreements, dealers were prohibited from selling to unlicensed or noncomplying dealers. *Id.* at 714. The system was enforced through surveillance of the licensed dealers and a lens identification system used to trace lenses sold to unlicensed dealers. *Id.* Dealers violating the license agreements were terminated. *Id.* at 715-16.

91. 362 U.S. 29 (1960). Parke, Davis had a pricing system that included minimum resale pricing and an enforcement program. *Id.* at 32-33. It issued a list of minimum resale prices and refused to sell to wholesalers who did not comply with the pricing scheme or who sold Parke, Davis products to non-complying retailers. *Id.* Parke, Davis enforced its resale pricing system with the cooperation of dealers and by threats of termination and boycotts of noncomplying retailers. *Id.* at 33-34. Noncomplying dealers were reinstated if they agreed to comply with Parke, Davis' pricing system. *Id.* at 35-36.

92. *Bausch & Lomb*, 321 U.S. at 723; *Parke, Davis*, 362 U.S. at 44.

93. *Bausch & Lomb*, 321 U.S. at 723; *Parke, Davis*, 362 U.S. at 45.
a system of suggested retail prices. Because such a system of enforcement requires cooperation and concerted action between the parties in the distribution system, the arrangement implies an agreement or combination that a court might, and in these cases did, find a restraint of trade.

After Parke, Davis, the Court had effectively limited the application of the Colgate principle to cases falling within the narrow Colgate fact pattern.\(^4\) That is, a manufacturer could establish a price list, announce its policies with respect to terminating noncomplying dealers, and unilaterally refuse to deal with distributors that did not comply with its prices.\(^5\) However, the manufacturer could not solicit assurances of compliance from dealers, enforce or coerce compliance from price cutters by enlisting the cooperation of other dealers to report them, or boycott price cutters in order to obtain compliance and then reinstate them.\(^6\) This view survived until the modern Court reviewed Colgate in the context of a dealer-initiated termination in Monsanto v. Spray-Rite Corp.\(^7\) By this time, the Reagan administration's appointments to the Court and growing acceptance of the Chicago School's efficiency theory provided the administration with the opportunity to effectively challenge the status of vertical restraints law.

**B. The Modern Trend: Vertical Restraints Promote Efficiency and Competition**

The economic efficiency theories of the Chicago School of antitrust law have significantly influenced the modern debate over the treatment of vertical price restraints.\(^8\) These theories shaped the Reagan administration's
policy, which advocates legalization of vertical price restraints, and placed the administration in opposition to Congress. The parties have taken the conflict to the judiciary, and recent Supreme Court decisions indicate that the Chicago School's efficiency theory has gained adherents on the Court.

1. Pre-Reagan Judicial Treatment of Vertical Restraints

Although prior decisions demonstrated the Court's growing awareness and interest in the economic impact of their decisions, Continental T.V., Inc. v. GTE Sylvania, Inc. clearly evidenced the influence of Chicago School theories on the Court's treatment of vertical restraints. A vertical nonprice restraint, which the Court had only a decade earlier declared illegal per se in United States v. Arnold, Schwinn & Co., triggered the Sylvania litigation. The Court reassessed and overruled Schwinn. The Court rationalized its application of the rule of reason standard to vertical nonprice restraints on the basis of the potential efficiencies and procompetitive benefits of these restraints. Intentionally or not, this decision set the stage for a challenge to the per se rule against vertical price fixing.

Sylvania, a television manufacturer, had terminated its wholesale dealers and developed a nonexclusive franchise system that limited the number of franchises in an area. The system also required franchisees to sell the

Case for a Per Se Rule Against Vertical Price Fixing, 71 Geo. L.J. 1487 (1983) (disputing the efficiency theorists' arguments in support of eliminating the per se proscription against vertical price fixing).


102. 388 U.S. 365 (1967). The history of the Court's treatment of vertical nonprice restraints illustrates the difficulty the Court has experienced in dealing with the economics of antitrust issues. In White Motor Co. v. United States, 372 U.S. 253 (1963), the Court applied the rule of reason standard to vertical nonprice restraints. Noting that not enough was known about the impact of these vertical arrangements on competition, the White Motor Court reversed a lower court decision applying the per se standard to nonprice restraints. 372 U.S. at 263-64.

Just four years later, however, the Court determined that it knew enough about the competitive effects of vertical restraints and overruled the White Motor decision in Schwinn. In Schwinn, the Court held the defendant's vertical customer and location restrictions illegal per se. 388 U.S. at 382. In dicta, the Court indicated that vertical nonprice restraints imposed on dealers constituted restraints on alienation by manufacturers that could so unreasonably restrict competition that a violation of the Sherman Act would result. Id. at 380.

103. Sylvania, 433 U.S. at 58.

104. Id. at 54-56.

105. Id. at 38.
merchandise only from prescribed locations. A disagreement arose between Continental, a successful franchisee, and Sylvania over the location of a new franchise near a Continental location. In protest of Sylvania's action, Continental opened an outlet at another location without Sylvania's approval. Sylvania terminated Continental for violating the franchise agreement, and Continental challenged the franchise contract's location restraint as a violation of the Sherman Act.

The trial court, following Schwinn, found Sylvania in per se violation of the Sherman Act. The Court of Appeals for the Ninth Circuit reversed the decision on the grounds that the jury instruction, which required a finding of a per se violation, was erroneous. The Supreme Court affirmed the Ninth Circuit's decision.

Reasoning that vertical nonprice restraints may promote economic efficiency and competition, the Court held that petitioners failed to show that such restraints had a "pernicious effect on competition or that they lack[ed] any redeeming virtue." Noting that the vertical nonprice restraints in Sylvania actually stimulated interbrand competition, the Court overruled Schwinn and held that the rule of reason was the appropriate evidentiary standard to apply to vertical nonprice restraints. Although the Court reaffirmed its support of the per se rule against vertical price fixing, Justice White noted in a prescient concurring opinion that these same procompetitive and efficiency justifications could support the application of the rule of reason standard to all vertical restraints and, therefore, the Court's opinion called into question the absolute prohibition against vertical price fixing.

106. *Id.*
107. *Id.* at 39.
108. *Id.*
109. *Id.* at 40.
110. *Id.* at 41.
113. *Id.* at 58 (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958)).
114. *Id.* at 38-39.
115. *Id.* at 57-59.
116. *Id.* at 51 n.18.
117. *Id.* at 70 (White, J., concurring).
118. *Id.* According to Justice White in his concurring opinion, the Court did not satisfactorily distinguish between price and nonprice restraints in its Sylvania decision. *Id.* at 69-70. The majority disposed of the issue by stating that the per se illegality of vertical price restraints involved significantly different issues of analysis and policy. *Id.* at 70. Justice White noted that the Court's failure to adequately explain why vertical price fixing did not give rise to the same efficiencies called into question the per se rule against vertical price fixing. *Id.*
2. Vertical Price Fixing Developments Under the Reagan Justice Department

During the Reagan terms, the administration pursued a policy designed to restrict the scope of and, ultimately, eliminate the per se rule against vertical price restraints. Under the direction of the Department of Justice, the Reagan administration policy succeeded in undermining both public and private vertical price fixing actions under the Sherman Act.119 First, the administration abdicated its responsibilities with respect to enforcement of the per se prohibition against vertical price fixing. Despite the number of private vertical price fixing suits brought during the Reagan administration,120 the DOJ had not instituted one government vertical price fixing action through 1986.121

Second, through a series of writings122 and amicus filings,123 the DOJ attempted to undermine private vertical price fixing actions and urged the Supreme Court to overturn the per se rule against vertical price fixing. Under an “amicus intervention program” established in 1981,124 the DOJ intervened on behalf of defendant manufacturers in private vertical price fixing antitrust suits.125 One of the DOJ’s most controversial briefs was filed in 1983 with the Supreme Court in Monsanto Co. v. Spray-Rite Service Corp.126 Therein, the DOJ urged the Court either to overturn the per se prohibition against vertical price fixing or to apply the per se standard only to explicit agreements to fix prices or price levels.127

Finally, the DOJ promulgated a set of “Vertical Restraints Guidelines”128 that detailed the DOJ’s policy with respect to enforcement of vertical re-

120. In the period from the Monsanto decision to 1987 alone, approximately 70 private vertical price fixing actions were instituted. Id.
121. S. REP. No. 280, supra note 16, at 2. In addition, the DOJ opened only six investigations during the Reagan administration, compared to the 40 it opened in the period 1976 to 1981. Id. at 23.
122. See, e.g., infra text accompanying notes 128-31.
123. See, e.g., infra text accompanying notes 124-27.
125. Id.
126. 465 U.S. 752 (1984); see Brief, supra note 14; see also Brief for the United States as Amicus Curiae, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) (No. 82-914) (urging the Supreme Court to grant Monsanto’s petition for writ of certiorari). The amicus filing in Monsanto was controversial for three reasons: (1) Congress fully supported the per se standard for vertical price fixing, (2) the status of the per se standard was not an issue that either party raised in the action, and (3) Monsanto was an important and very visible case, and therefore, there was no assurance that the Court would not address the per se issue. See H.R. REP. No. 421, supra note 15, at 4-10; S. REP. No. 280, supra note 16, at 3-5.
128. GUIDELINES, supra note 12.
Purporting to deal only with vertical nonprice restraints, the guidelines essentially established a no-action policy with respect to vertical price restraints. The guidelines stated that where a manufacturer had a bona fide distribution program embodying nonprice and price restraints, the DOJ would analyze the system using the rule of reason under either of two conditions. The DOJ would use the rule of reason if there was no "direct or circumstantial evidence (other than effects on price) establishing an explicit agreement as to specific prices," or where "the nonprice restraints [were] plausibly designed to create efficiencies . . . and the price restraint [was] merely ancillary to the nonprice restraint." 

3. Judicial Treatment of Vertical Price Restraints During the Reagan Administration

_Monsanto Co. v. Spray-Rite Service Corp._ was the first major vertical price fixing case of the Reagan era. The Supreme Court's decision in _Monsanto_ can be seen as a victory for the Reagan administration's efforts to undermine or eliminate the per se rule against vertical price fixing. In _Monsanto_, the DOJ submitted an amicus brief urging the Court to overturn the per se rule. While the Court declined to address the issue directly, it placed an additional burden of proof on the plaintiff not found in other areas of antitrust law, thereby significantly narrowing the per se standard's scope as applied to vertical price fixing.

The issue in _Monsanto_ was whether a manufacturer's unilateral action or the concerted action of the manufacturer and a complaining dealer caused a dealer's termination. Spray-Rite, a distributor of Monsanto products, sued...
Monsanto under section 1 of the Sherman Act for terminating Spray-Rite's distributorship.\textsuperscript{137} Spray-Rite alleged that competing distributors' complaints about Spray-Rite's failure to comply with Monsanto's suggested prices resulted in its termination.\textsuperscript{138} Further, Spray-Rite alleged that Monsanto and the complaining distributors conspired to fix resale prices and took other actions in furtherance of that conspiracy.\textsuperscript{139} Monsanto countered that Spray-Rite was terminated because of its failure to provide adequate nonprice promotional services.\textsuperscript{140}

The jury found that Monsanto's actions were in furtherance of a conspiracy to fix resale prices and, therefore, were a per se violation of section 1 of the Sherman Act.\textsuperscript{141} The United States Court of Appeals for the Seventh Circuit affirmed the district court's decision and established a standard of proof under which a dealer's termination following the complaints of a rival dealer could give rise to an inference of concerted action.\textsuperscript{142}

The Supreme Court affirmed the district court's decision but reversed the appeals court's standard of proof and established a more stringent standard.\textsuperscript{143} Reasoning that allowing a jury to infer an agreement to fix prices from a dealer's termination following the complaints of a rival dealer might deter economically efficient and procompetitive conduct,\textsuperscript{144} the Court declared that mere evidence of dealer complaints was not sufficient to prove an agreement to fix prices.\textsuperscript{145} Rather, the plaintiff must present direct or circumstantial evidence that tends to exclude the possibility of independent action by the manufacturer and distributor.\textsuperscript{146} The Court, however, found that the plaintiff had met this more stringent burden of proof and affirmed the lower court decision.\textsuperscript{147}

\textit{Monsanto} defined a new evidentiary standard for proof of a vertical conspiracy to fix prices. The Court shifted the burden of proof to the plaintiff to disprove independent action and, thus effectively revitalized \textit{Colgate's dis-}

\begin{itemize}
\item \textsuperscript{137} \textit{Monsanto}, 465 U.S. at 757.
\item \textsuperscript{138} \textit{Id.} at 758-59.
\item \textsuperscript{139} \textit{Id.} at 757-58. Actions in furtherance of the conspiracy included boycotting Spray-Rite and the use of compensation programs, areas of primary responsibility and shipping policies to fix, maintain, or stabilize prices. \textit{Id.}
\item \textsuperscript{140} \textit{Id.} at 757.
\item \textsuperscript{141} \textit{Id.} at 757-58.
\item \textsuperscript{142} \textit{Id.} at 758-59.
\item \textsuperscript{143} \textit{Id.} at 759.
\item \textsuperscript{144} \textit{Id.} at 762-64.
\item \textsuperscript{145} \textit{Id.} at 764.
\item \textsuperscript{146} \textit{Id.} The Court stated that the plaintiff's evidence must reasonably tend to prove that the manufacturer and others had "a conscious commitment to a common scheme designed to achieve an unlawful objective." \textit{Id.}
\item \textsuperscript{147} \textit{Id.} at 765, 768.
\end{itemize}
tinction between concerted and independent action.\textsuperscript{148} Again, the Court based its holding on the efficiencies resulting from conduct that might be perceived as price fixing.\textsuperscript{149} The decision was controversial and confusing for a number of reasons.

First, many lower courts interpreted the decision as requiring direct or circumstantial evidence of an explicit agreement between the manufacturer and complaining dealer to fix prices or price levels.\textsuperscript{150} Second, Congress and the lower courts interpreted \textit{Monsanto} as removing from the jury its traditional antitrust charge of drawing inferences of a conspiracy from a set of facts.\textsuperscript{151} In some cases, the lower courts required the plaintiff to prove that an explicit agreement existed rather than allowing the jury to infer an agreement from a termination "following" or "in response to" complaints from a dealer.\textsuperscript{152} Third, the Court's decision revealed an unjustifiable lack of confidence in the jury's ability to distinguish legitimate from illegitimate business practices.\textsuperscript{153} Fourth, by requiring evidence disproving independent action on the part of the manufacturer and dealer, the \textit{Monsanto} decision substantially increased the quantum of proof needed for a plaintiff's action to reach

\begin{itemize}
\item \textsuperscript{148} Id. at 762-63; see also supra text accompanying notes 72-77.
\item \textsuperscript{149} \textit{Monsanto}, 465 U.S. at 762-64.
\item \textsuperscript{150} See Garment Dist., Inc. v. Belk Stores Serv., Inc., 799 F.2d 905 (4th Cir. 1986) (manufacturer's action in terminating a discounter was unilateral, despite evidence of the coercive acts of a rival dealer and a pretextual nonprice restraint's defense), \textit{cert. denied}, 108 S. Ct. 1728 (1988); McCabe's Furniture, Inc., v. La-Z-Boy Chair Co., 798 F.2d 323 (8th Cir. 1986) (application of per se standard to a dealer termination was in error because nonprice as well as price factors motivated the termination), \textit{cert. denied}, 108 S. Ct. 1728 (1988); Morrison v. Murray Biscuit Co., 797 F.2d 1430 (7th Cir. 1986) (wholesale dealer failed to prove he was terminated pursuant to a conspiracy to suppress price competition between a supplier and a rival dealer); Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216 (10th Cir. 1986) (in the absence of evidence of an agreement to raise prices, an agreement between a supplier and dealer to terminate a rival dealer is not illegal per se), \textit{cert. denied}, 108 S. Ct. 1728 (1988); Business Elecs. Corp. v. Sharp Elecs. Corp. 780 F.2d 1212 (5th Cir. 1986) (district court erred in finding manufacturer's termination of a dealer a per se violation of the Sherman Act without proof of an explicit agreement on prices), \textit{aff'd}, 108 S. Ct. 1515 (1988). Although the \textit{Monsanto} decision did not specifically state that an explicit agreement was required, many jurisdictions have interpreted it that way. The evidence presented in the above cases was sufficient to prove a conspiracy between a manufacturer and dealer to terminate a rival dealer for price cutting, but the appeals courts generally held that \textit{Monsanto} did not permit an inference of a conspiracy to suppress price competition. H.R. REP. No. 421, supra note 15, at 21-25. Something more than evidence of complaints was needed. Id. Exoneration of the manufacturers was invariably based on the procompetitive benefits of nonprice restraints. Id.
\item \textsuperscript{151} H.R. REP. No. 421, supra note 15, at 17-18.
\item \textsuperscript{152} See cases cited supra note 150.
\item \textsuperscript{153} H.R. REP. No. 421, supra note 15, at 19-20. This is a function that the jury freely exercises in other areas of antitrust, such as monopolization cases under section 2 of the Sherman Act. Id.
\end{itemize}
the jury.\textsuperscript{154} Finally, the decision impliedly attached greater weight to the potential efficiencies and procompetitive benefits of the conduct than to the very real impact of the dealer's termination on price competition.\textsuperscript{155}

4. Congressional Response: Vertical Price Fixing is Illegal Per Se

Congress expressed its unequivocal support of the per se rule against vertical price fixing when it passed the Consumer Goods Pricing Act of 1975,\textsuperscript{156} which rescinded the state fair trade exemption. The subsequent executive actions and judicial decisions undermining the rule\textsuperscript{157} understandably troubled Congress and prompted legislative action to prevent further erosion of the rule. First, Congress used its funding powers to restrain the DOJ's efforts to undermine the per se rule.\textsuperscript{158} Prior to the DOJ's oral argument of its Monsanto amicus filing, Congress passed the DOJ appropriation bill for 1984.\textsuperscript{159} The bill prohibited the DOJ from using its funds to urge the reversal of the per se rule against vertical price fixing.\textsuperscript{160}

Second, Congress passed a resolution vehemently rejecting the DOJ's non-enforcement policy with respect to vertical restraints law.\textsuperscript{161} The DOJ's lack of enforcement of vertical restraints law during the Reagan administra-

\textsuperscript{154} Id. at 16-17; see infra text accompanying notes 207-08.

\textsuperscript{155} See supra text accompanying notes 207-73. The Monsanto Court noted that a finding of a per se violation might deter legitimate manufacturer-dealer communication designed to assure that the product reaches the consumer efficiently. Monsanto, 465 U.S. at 763-64. Dealer terminations "in response to" complaints from a dealer about price cutting have a very real, although indirect, impact on prices and are equivalent to a boycott. See Gerla, supra note 98, at 9-12.


\textsuperscript{157} See supra text accompanying notes 119-55.


\textsuperscript{159} 1984 Appropriations Act, supra note 158.

\textsuperscript{160} Id. The bill, in effect, prevented Assistant Attorney General William Baxter from orally arguing the DOJ's Monsanto amicus brief, which urged the reversal of the per se rule, before the Supreme Court. Id.; see also H.R. REP. No. 421, supra note 15, at 5.

\textsuperscript{161} 1986 Appropriations Act, supra note 158, at 1169-70. The DOJ had not brought a single government price fixing case since 1981 and had conducted only six investigations, none of which were ever brought to trial. S. REP. No. 280, supra note 16, at 2, 23.
Four months after the expiration of the 1984 funding restriction, the DOJ released the "Vertical Restraints Guidelines of January 23, 1985," which established its policy on enforcement of vertical restraints law. Congress viewed the guidelines as another attempt to influence judicial treatment of vertical price fixing and to dilute the per se standard by blurring the distinction between price and nonprice restraints. In response, Congress passed the Vertical Restraints Guidelines Resolution. In the resolution, Congress rejected the DOJ's enforcement policy and interpretation of the law as stated in the guidelines and demanded that the Attorney General recall the guidelines. In addition, Congress stated in the resolution that the courts should not construe the guidelines as an accurate representation of either current antitrust law or Congress' position on vertical price fixing.

Finally, the Monsanto decision itself prompted a congressional reaction. Congress saw the Monsanto decision as hindering private antitrust actions and remedies at a time when government enforcement of vertical price fixing law was lacking. Although the Monsanto decision reaffirmed the per se standard for vertical price fixing, it was the first evidence that the Reagan administration's "efficiency" view was beginning to influence lower court and Supreme Court decisions relating to vertical price fixing. In response, Congress proposed amendments to the Sherman Act that would restore the per se standard to its pre-Monsanto status. These bills, pending when the

163. Upon assurances from the DOJ that it would enforce vertical price fixing law as interpreted by the Supreme Court, the 1984 funding restriction against the DOJ's vertical price fixing activities was allowed to expire on October 1, 1984. Thus, the 1985 bill deleted all references to vertical restraints. Id. at 3.
164. See Guidelines, supra note 12; text accompanying notes 128-31.
165. 1986 Appropriations Act, supra note 158, at 1169.
166. Id. at 1169-70.
167. Id.
168. Id. The Resolution stated that the DOJ's Vertical Restraints Guidelines:

(1) are not an accurate expression of the Federal antitrust laws or of congressional intent with regard to the application of such laws . . . ;

(2) shall not be accorded any force of law or be treated by the courts of the United States as binding or persuasive; and

(3) should be recalled by the Attorney General.

Id.
100th Congress ended, were reintroduced in the 101st Congress.\(^{171}\)

Congress' rescission of the state fair trade exemption in 1975 reestablished its position on vertical price fixing and the per se standard. The \textit{Monsanto} decision prompted congressional action which reaffirmed Congress' unequivocal and consistent support for the per se rule against vertical price fixing and evidenced Congress' intent to maintain the standard. This clear record of congressional support for the per se standard existed prior to the time the Court heard \textit{Business Electronics Corp. v. Sharp Electronics Corp.}\(^{172}\) Consequently, \textit{Sharp} provided an opportunity for the Court either to defer to Congressional intent by reinstating the pre-\textit{Monsanto} standard, or to adopt the administration's position by further limiting or overturning the per se standard.

\section*{III. \textit{Business Electronics Corp. v. Sharp Electronics Corp.}}

In \textit{Sharp}, the Court further narrowed the absolute prohibition against vertical price fixing in the context of a dealer termination. Justice Scalia, writing for the majority, addressed the issue of the standard applicable to a dealer termination and affirmed the appeals court's application of the rule of reason.\(^{173}\) Characterizing the restraint at issue as a vertical nonprice restraint, Justice Scalia stated that the Court's holdings in \textit{Sylvania} and \textit{Monsanto} dictated a presumption for applying the rule of reason to vertical nonprice restraints.\(^{174}\) Justice Scalia found no evidence that an agreement to terminate a discounting dealer, without an additional agreement between the manufacturer and a complaining dealer on prices, restricted competition or

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\item[171.] The new Senate and House versions of these bills were introduced in the first session of the 101st Congress. The Senate version, S. 865, was introduced on April 19, 1989, 135 \textsc{Cong. Rec.} 4435, 4437 (daily ed. Apr. 19, 1989). The House version, H.R. 1236, was introduced on March 2, 1989. 135 \textsc{Cong. Rec.} H510, 527 (daily ed. Mar. 2, 1989). The major change from the previous versions is the prohibition of the conduct permitted by the Court in \textit{Sharp}. In response to the Supreme Court decision in \textit{Sharp}, the new versions proscribe agreements between a seller and a dealer to terminate another dealer for its pricing policies, whether or not prices or price levels are agreed upon. \textit{Id.}
\item[172.] 108 S. Ct. 1515 (1988).
\item[173.] \textit{Id.} at 1517, 1525.
\item[174.] \textit{Id.} at 1520. Citing \textit{Sylvania} and \textit{Monsanto}, Justice Scalia stated that departure from the rule of reason standard should "be based on demonstrable economic effect rather than . . . upon formalistic line drawing." \textit{Id.} (citing Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58-59 (1977)). Noting that vertical nonprice restraints have certain procompetitive benefits, Justice Scalia declared that vertical nonprice restraints had not been shown to have such a "pernicious effect on competition and lack of any redeeming virtue" as to warrant a standard of per se illegality. \textit{Id.} at 1519 (citing \textit{Sylvania}, 433 U.S. at 58).
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\end{footnotesize}
reduced output. To the contrary, Justice Scalia indicated that such restraints could promote competition and economic efficiencies that would not be realized if the Court applied a per se standard.

Justice Scalia then focused on the interbrand-intrabrand competition distinction. Noting that interbrand competition is the principal concern of antitrust law, Justice Scalia declared that as long as the per se standard protected interbrand competition, it was not needed to protect intrabrand competition. First, Justice Scalia stated that interbrand competition provided a significant check on attempts to exploit intrabrand market power. Second, a per se standard of illegality encompassing all vertical restraints created a perverse incentive for manufacturers to vertically integrate, which would result in fewer small businesses and higher market concentration. Third, vertical nonprice restraints, unlike vertical price restraints, do not facilitate cartelization and, therefore, do not require a per se standard to

175. *Id.* at 1521.

176. *Id.* at 1519-20. Manufacturers can use these restraints to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. . . . [and to] induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. . . . The availability and quality of such services affect a manufacturer’s goodwill and the competitiveness of his product. Because of market imperfections such as the so-called ‘free-rider’ effect, these services might not be provided by retailers in a purely competitive situation . . . .

*Id.* (quoting Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 55 (1977)).

177. *Id.* at 1519.

178. *Id.* at 1520.

179. *Id.* Theoretically, if a manufacturer attempts to exploit intrabrand market power by raising prices, consumers will switch to the lower priced product of a rival manufacturer. *Sylvania*, 433 U.S. at 52 n.19. This result, however, depends on the convenience to consumers, the amount of competition, and the ability of consumers to exploit this competition. *Id.* at 54.

180. *Sharp*, 108 S. Ct. at 1520. This argument assumes that if the per se standard prevents the utilization of nonprice restraints to achieve distributive efficiencies, the manufacturer will vertically integrate by purchasing or establishing retail businesses, thereby eliminating the small, independent distributorships. *Sylvania*, 433 U.S. at 57 n.26. A manufacturer’s decision to vertically integrate, however, involves more than just a consideration of distributive efficiencies. Although transaction costs may decline, a manufacturer must also consider the capital investment and expertise required and the additional risk inherent in a decision to vertically integrate. See Halverson, An Overview of Legal and Economic Issues and the Relevance of the Vertical Merger Guidelines, 52 ANTITRUST L.J. 49, 80-81 (1983). Therefore, the decision is not simply a choice between vertical nonprice restraints or vertical integration.

181. *Sharp*, 108 S. Ct. at 1520. A cartel is a combination or association of companies joined together to control competition in the pricing, marketing, or production of a product. A cartel often attempts to monopolize a particular product or industry. The critical issue with respect to vertical price fixing by members of a cartel is whether a group of manufacturers is able to stabilize or maintain prices at an agreed level. Manufacturers often use competitors’ retail prices to monitor compliance with the agreed prices. See Pitofsky, *supra* note 61, at 16.
prevent anticompetitive conduct.  

Next, Justice Scalia reasoned that the application of the per se standard to manufacturers' actions that are not based on price agreements would deter or penalize legitimate communication or conduct between manufacturers and dealers. One of the rationales for the Sylvania Court's rejection of the per se standard for vertical nonprice restraints, he noted, was to allow such procompetitive communication or conduct. Justice Scalia reasoned that imposing a per se standard in this situation would encourage terminated discounters to allege price fixing in order to attack terminations for nonprice reasons and would deter legitimate and competitively useful conduct. The rule of reason adequately protected dealers against unreasonable restraints of trade. Rejecting the plaintiff's and the dissent's remaining arguments, Justice Scalia concluded that economic analysis supports the view that vertical restraints should not be illegal per se unless they include an explicit agreement to fix prices.

In a lengthy dissent, Justice Stevens rejected the majority's characterization of the issue as one concerning vertical nonprice restraints. Justice Stevens contended that an agreement initiated by a complaining dealer to terminate a competing dealer because of the competing dealer's price cutting policies was not a nonprice restraint, but rather an unreasonable restraint on price competition. A more proper analysis of the issue, he stated, would have focused on horizontal restraints and the distinction between naked and

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182. *Sharp*, 108 S. Ct. at 1520. The dissent argued and this Note argues that a termination of a dealer for price cutting is a price restraint and, therefore, will facilitate cartelization. *Id.* at 1530 (Stevens, J., dissenting).
183. *Id.* at 1520 (majority opinion).
184. *Id.*
185. *Id.* at 1521.
186. *Id.* at 1524-25. Justice Scalia rejected BEC's arguments that the application of the per se standard to this vertical restraint was controlled by precedent on horizontal restraints and by vertical restraint cases that established that no explicit agreement on prices or price levels was required to apply the per se standard. *Id.* He also disagreed that a price agreement will always follow from a dealer's termination and noted that a dealer's termination may quite plausibly be motivated by a desire to induce dealer services rather than to fix prices. *Id.* at 1523.
187. *Id.* at 1522-23. Justice Scalia rejected the dissent's characterization of BEC's termination as a naked restraint of competition at the retail level. *Id.* He stated that there is a quite plausible purpose of this restraint; specifically, to induce a dealer to provide services, which therefore makes the restraint ancillary. *Id.* In addition, Justice Scalia concluded that BEC's termination was not a horizontal restraint because a manufacturer imposed it, not other dealers. *Id.*
188. *Id.* at 1525.
189. *Id.* at 1526 (Stevens, J., dissenting).
190. *Id.*
ancillary restraints of trade. The dissent asserted that BEC's termination was comparable to a group boycott, therefore, the Court's holding in United States v. General Motors Corp. should control.

Justice Stevens noted that past Court decisions had permitted reasonable covenants in restraint of trade if they were ancillary to the main purpose of a contract and did not violate the rule of reason. Justice Stevens argued, however, that the subject restraint was neither a term of nor ancillary to Sharp's dealership agreements with BEC and Hartwell and was, therefore, not a vertical nonprice restraint. He found the majority's reliance on Sylvania misplaced. Distinguishing Sylvania's contractual location restraint, Justice Stevens noted that Sharp had not imposed any vertical nonprice restraints, such as location, territory, or customer requirements, on either BEC or Hartwell. Because neither BEC nor Hartwell were contractually obligated to provide dealer services, the procompetitive benefits that the majority posited as resulting from this "nonprice restraint" were mere possibilities. Thus, BEC's termination was a naked restraint with no purpose but to suppress price competition.

Justice Stevens next examined the character of the termination in order to illustrate its anticompetitive nature. He contended that the Court should have focused on the character of the agreement and its economic consequences, rather than on the number of parties involved in the agreement. Criticizing the majority's summary disposal of General Motors and Klor's, Inc. v. Broadway-Hale Stores, Inc., Justice Stevens found that the principal elements of a group boycott established in those cases were also present here. He argued that BEC's termination accomplished the same purpose,
and differed only in degree from that struck down in General Motors. The agreement, Justice Stevens concluded, was a naked horizontal restraint on price competition rather than an ancillary vertical nonprice restraint designed to further the manufacturer’s distributional policies.

Finally, Justice Stevens criticized the majority’s interpretation of Sylvania as permitting the elimination of intrabrand competition based only on the “quite plausible” assumption of improvements in interbrand competition. He asserted that Sylvania required something more than a mere possibility of a benefit to interbrand competition. Justice Stevens concluded that this restraint provided no demonstrable improvements to interbrand competition, therefore, the restraint should not evade the Court’s rule of per se illegality by the mere possibility of procompetitive benefits. He criticized the majority’s “plausible purposes” justification for this naked restraint as contrary to one of the fundamental objectives of the Sherman Act — to foster price competition.

IV. VERTICAL RESTRAINTS: AN ECONOMIC CONTROVERSY AND AN EVIDENTIARY DEBATE

Underlying the Court’s decision in Sharp is a growing dissatisfaction with the per se rule against vertical price fixing. While the Sharp Court preserved the per se standard in form, it significantly narrowed its applicability to cases where an aggrieved party can prove the existence of an explicit agreement on prices or price levels, thereby undermining the standard’s vitality. After Monsanto and Sharp, the terminated dealer’s burden of proof increased substantially; indeed, it has been equated to a burden requiring proof of a formal offer and acceptance. In establishing such a stringent evidentiary stan-

Stevens noted that BEC's termination was not an independent action controlled by the Colgate decision, but a concerted action motivated by an ultimatum from a complaining dealer. Id. at 1529-32. Elimination of price competition on the dealer level, rather than the violation of a vertical nonprice restraint, was the primary motivating factor in the termination of BEC. Id. at 1532. The economic consequences arising from the coercive activities of one competing dealer on the manufacturer are as pernicious as those resulting from the coercive activities of a number of competing dealers. Id. Thus, the sole difference between this action and a group boycott was the number of parties involved. Id.

202. Id. at 1531-32.
203. Id. at 1532.
204. Id. at 1536. If a per se standard could be avoided simply by positing a "plausible purpose," then the same purposes could be cited to evade the application of a per se standard in other price fixing cases where it might be argued that the defendant could provide better services. Id.
205. Id.
206. Id.
207. Id. at 1525.
dard, the Court has effectively enabled a manufacturer and dealer to circum-
vent the per se standard and fix or maintain prices by terminating a 
discounting dealer. The complexity and expense of a rule of reason case will 
deter terminated dealers from bringing actions against manufacturers and 
will likely allow manufacturers to terminate dealers abusively and with 
impunity.

The increase in the plaintiff’s burden of proof will result in less legal pro-
tection for discounters and more dealer terminations. The loss of dis-
counters will result in a number of unfavorable economic consequences. 
First, inflationary pressures $^{209}$ and higher prices $^{210}$ will follow the reduction 
in price competition. Second, reduced consumer choice will result in lower 
consumer utility $^{211}$. Third, inefficient manufacturers and dealers will insu-
late themselves from the competitive market through vertical price fixing. $^{212}$ 
Finally, business failures will increase and new business start-ups will de-
crease in a vertical price fixing environment $^{213}$ *Monsanto* and *Sharp* reduce 
both intrabrand and interbrand competition and, thus, create less competi-
tive industries, diminish consumer welfare, and produce less flexible and effi-
cient price and distribution systems.

However, the Court and the administration argue that less price competi-
tion is beneficial if it results in better sales services, eliminates market imper-
fecions such as free riding, and increases output by attracting new dealers to

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209. See Hearings, supra note 13, at 69.


211. See, e.g., Gerla, supra note 98, at 3-5. All consumers do not desire the same level of prices and services, and the elimination of the discounter will result in more standardized and uniform distribution channels. Discounters provide the customer with alternative price/product/service mixes that increase consumer choice and maximize consumer welfare. *Id.*

212. Pitofsky, supra note 61, at 15-16. At the manufacturer level, inefficient manufacturers will be able to maintain prices at levels that reduce dealer pressure to lower wholesale prices, thereby insulating themselves from the competitive markets. *Id.* Neither the manufacturer nor dealer will have to compete on the merits of the product or on a price basis. Promotional or nonprice competition will take over as it has done in the automobile industry. The reduction in price pressure on the manufacturer from the discounter will result in less competitive industries. See generally Gerla, *Competition on the Merits — A Sound Industrial Policy for Antitrust Law*, 36 U. FLA. L. REV. 553 (1984).

213. S. Rep. No. 466, supra note 13, at 3, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 1569, 1571-12. New dealers are generally more efficient than established dealers and compete primarily on a price basis. *Hearings, supra* note 13, at 105 (statement of Mr. Monroe G. Milsstein, Chairman of Burlington Coat Factory, citing 1975 Justice Department Study). *Id.* at 102. Vertical price fixing will deter the establishment of new businesses if these businesses cannot compete on a price basis. *Id.*
invest in the capital and labor required to distribute more efficiently. The Sharp Court termed these factors the "quite plausible purpose[s]" of Sharp's termination of BEC. Those advocating the elimination of the per se rule against vertical price fixing also utilize these same arguments.

The Chicago School and the DOJ argue that economic efficiency factors should control in determining an evidentiary standard for vertical restraints. They contend that the procompetitive benefits and efficiencies of vertical restraints justify at least applying the rule of reason to vertical restraints if not a standard of per se legality. Traditional antitrust advocates oppose the elimination of the per se standard and argue that vertical price fixing promotes neither efficiency nor consumer welfare. Although procompetitive benefits and efficiencies may result from vertical price fixing, advocates contend that the pernicious effects on competition outweigh such speculative benefits.

The legal debate over the appropriate standard to apply to vertical restraints, specifically price restraints, understandably arises from the inability of scholars to agree on the effects of these restraints on the business environment. Economics scholars agree, and empirical evidence shows, that prices are higher under vertically-fixed prices than under unrestrained price competition. Scholars disagree, however, over whether the procompetitive benefits realized from vertical price fixing sufficiently warrant the suppression of price competition. The Sharp Court decided that the benefits to competition and efficiency, which a dealer termination might produce, so outweighed the effects on price competition that the plaintiff's additional evidentiary burden of proving an agreement on price or price levels was justified.

214. Business Elecs. Corp. v. Sharp Elecs. Corp., 108 S. Ct. 1515, 1519-20 (1988). Under this theory, the demand induced by increased services and information more than offsets the dampening effect of higher prices on demand. See supra note 8. The argument implies that higher prices result in more or better services. There is no empirical evidence to show, however, that one follows directly from the other.


217. See supra note 8.

218. See, e.g., sources cited supra note 8; GUIDELINES, supra note 12; Brief, supra note 14.

219. See, e.g., supra note 10; Scherer, supra note 98; Gerla, supra note 98.


221. Compare, e.g., Scherer, supra note 98 and Pitofsky, supra note 98 with Posner, supra note 8 and Bork, supra note 8.
A. Dealer Services and the Free Rider Problem

The Court's decision in Sharp rested on the assumption that vertical restraints are procompetitive and efficiency enhancing. Proponents of vertical price fixing advance the correlative argument that manufacturers may use vertical restraints to induce dealers to provide important sales services. Proponents state that the purpose of vertical price fixing is not to raise consumer prices but to increase output, which is economically efficient and procompetitive. Permitting a manufacturer to set a resale price that provides the dealer with a high profit margin consequently induces the retailer to invest in sales services in order to increase sales and realize higher profit margins. As a consequence, the manufacturer realizes both distributive and allocative efficiencies.

Closely related to the sales services issue is the problem of discounters "free riding" on the sales and promotion services of full price dealers.

222. In addition to motivating a dealer to provide sales services, eliminating the free rider problem, and encouraging new dealer investment in product distribution, the arguments in favor of vertical price fixing are that it protects small dealers, it permits a manufacturer to preserve brand image, and it discourages the use of the product as a loss leader. See S.C. Oppenheim, G. Weston & J.T. McCarthy, Federal Antitrust Laws: Cases, Text and Commentary, 540-44 (4th ed. 1981). But see Pitofsky, supra note 98, at 1491-94.

223. 108 S. Ct. at 1520.


225. See Bork, supra note 8, at 397-405. Nonprice factors such as services are as important an influence on demand and output as price. Proponents argue that growth in demand and output attributable to the increased services would more than offset the decrease in demand and output due to the higher retail price. Id.; see also R. Posner & F. Easterbrook, supra note 224, at 211-15.

226. R. Posner & F. Easterbrook, supra note 224, at 211-15. Proponents argue, however, that the cost of unrestrained service competition will dissipate additional profits to the point where marginal cost equals price, resulting in maximum distributive efficiency. Id.

227. Id. Higher profit margins will induce dealers to increase sales services such as advertising, promotion, and in-store demonstrations and displays. Id. These pre-sale services will, in turn, increase sales by persuading more consumers to buy the product. Id. The increase in economies of scale will reduce per-unit transaction and distribution costs, increasing distributive efficiencies. Id. Higher output will allow manufacturers to sell at a price closer to marginal cost and achieve allocative efficiencies. Id. But see Scherer, supra note 98, at 697-705 (arguing that vertical restraints reduce efficiency where competitors' services cancel each other out, where consumers have less choice, and where high prices attract entrants into a saturated market); Comanor, supra note 98, at 988-98 (arguing that where all consumers do not demand the same level of services, vertical restraints may not increase efficiency).

228. See Telser, supra note 216, at 91-92. Free riders are dealers that can sell products at discounted prices because they allegedly do not incur the promotional costs associated with a full service dealership. Id. The discounter "free rides" on the pre-sale services provided by full service dealers. Id. Essentially, these pre-sale services persuade the customer to purchase the product, but, instead of purchasing the product from the full service dealer at the higher price, the customer purchases it from the discounter. Id. Since the customer can free ride on
Proponents of vertical price fixing contend that free riding discourages dealers from providing sales services. The free rider can sell at a lower price and take sales away from full service dealers because the free rider does not incur the high costs of sales services. By eliminating price competition, vertical price fixing guarantees dealers the revenues to offset the expense of additional sales services. Moreover, it reduces free riding by allowing manufacturers to either terminate free riders or refuse to supply them.

Opponents of vertical price fixing contend that these efficiencies and procompetitive effects are merely theoretical benefits and that the anticompetitive effects are more pernicious than vertical price fixing proponents indicate. First, they assert that the concept of the “free rider” has never been empirically proven. The generalization that discounters offer lower prices because they fail to provide services is unfounded. Discounters often provide sales services that equal or exceed full price retailers’ services. Thus, it is more likely that discounters offer lower prices because they provide these services more efficiently. Vertical price fixing, therefore, prevents more efficient dealers from passing the benefits of their efficiencies to the consumer through reduced retail prices.

Second, vertical price fixing protects the inefficient manufacturer from having to compete for dealers and sales on a price basis. Assuring the dealer an adequate profit margin through vertically-fixed prices diminishes the pressure on the manufacturer to reduce prices to dealers in a highly competitive market. The manufacturer may simply terminate the discounter to alleviate the pressure on the wholesale price.

the services of the other dealer, the discounter has no incentive to provide these services and incur the costs. Id. Eventually, the full service dealer curtails its promotional services, injuring the manufacturer by reducing sales, and the consumer by reducing competition. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 55 (1977). See also Comanor, supra note 98, at 987; Gerla, supra note 98, at 3. See generally sources cited supra note 8.


230. Bork, supra note 8, at 453-56; Baxter, supra note 8, at 21; see also Comanor, supra note 98, at 987.


233. Id.

234. Pitofsky, supra note 98, at 1493; see also R. STEINER, infra note 249, at 3, 13-21. The large markups of full price retailers are often due to inefficient operations and practices such as poor space and labor utilization, excessive advertising, overcapacity, bundling of sales services rather than charging for services based upon use, and high transaction and other overhead costs. Gerla, supra note 98, at 4-5.

235. See Gerla, supra note 98, at 4-5.

236. Pitofsky, supra note 98, at 1490-91.
Third, to the extent vertical price fixing induces services, it does so inefficiently.\(^{237}\) It does not guarantee the level or types of services that the manufacturer desires or needs. In fact, it does not guarantee that the dealer will provide any services at all. A services requirement in the dealer agreement provides a more efficient and less restrictive means of assuring an appropriate level and type of service from a dealer.\(^ {238}\) The dealer's failure to supply the contractually required services would result in a breach of the dealer agreement and a justifiable termination of the violating dealer.

Inefficiencies also result from a system that removes the price/product/service mix determination from the market.\(^ {239}\) The assumption that the manufacturer knows better than the market the appropriate level and mix of services, and the price that would achieve them, does not comport with the lessons of competitive market economics. A system that allows consumers to choose between different price/product/service mixes and gives the dealer the flexibility to respond to these demands more efficiently allocates resources.\(^ {240}\)

Finally, the argument that vertical price fixing eliminates the free rider problem provides only weak justification. Because a vertical price fixing system imposes no obligation to provide a certain level or type of service, a dealer will always find it more profitable to "cheat" by reducing the level of sales services it provides and riding free on the services of other dealers.\(^ {241}\) Again, a sales services provision in the dealer agreement more efficiently and less restrictively assures that alleged free riders provide the level and type of service that the manufacturer deems necessary.\(^ {242}\)

B. Attracting New Dealers to Invest in Distributing the Product

The Sharp Court noted that vertical restraints have the potential to induce competent and aggressive retailers to invest in the capital and labor needed to distribute a product more efficiently.\(^ {243}\) Proponents of vertical price fixing also advance this argument in support of their view. Vertical price fixing

\(^{237}\) Id. at 1493.

\(^{238}\) Id.

\(^{239}\) Id.

\(^{240}\) Id.

\(^{241}\) Halverson, supra note 180, at 64.

\(^{242}\) Id. The manufacturer structures the agreement with the dealer to assure that certain services are provided in line with the manufacturer's promotional needs and the customer's informational needs. Without a vertical price fixing agreement, the dealer has the flexibility to adjust his price to a level that takes advantage of any efficiencies in the provision of these services. Id.; see also Pitofsky, supra note 98, at 1493.

provides an incentive, in the form of a higher profit margin, to attract new dealers to invest in a product’s distribution. Increasing the number of dealers provides the consumer with more choice and more product information, thereby increasing distributive efficiency and enhancing consumer welfare.

Opponents argue that vertical price fixing is not needed to attract new dealers and may even reduce efficiency. In a market characterized by low sales and high demand potential, the manufacturer wants to attract new dealers to invest in distribution in order to realize this potential. However, allowing the manufacturer to raise the price to consumers to attract new dealers generates considerable controversy. A more economically efficient solution would compel a manufacturer to compete for new dealers by lowering wholesale prices.

Opponents also contend that vertical price fixing hinders the expansion and survival of new businesses. The survival of a new business often depends on its ability to exploit any cost advantages by cutting prices in order to attract and develop a customer base. Vertical price fixing removes pricing discretion and, consequently, reduces the ability of new retailers to attract customers. Eliminating price competition as a marketing strategy may contribute to the demise of many new businesses. The high number of business failures, the low rate of business start-ups, and high consumer prices during the fair trade period demonstrate this potential.

Attracting new dealers into a demand-saturated market may be inefficient. Demand for the product does not increase, but instead shifts from one new dealer to another. “Competitors’ services simply cancel each other out” and the dealers cannibalize each other’s sales. In addition, as sales are reallocated among more dealers in a saturated market, dealers lose economies of

245. See R. BORK, supra note 8, at 288-91, 297-98.
246. See Pitofsky, supra note 98, at 1494; Scherer, supra note 98, at 704-05.
247. Pitofsky, supra note 98, at 1494.
248. Id.
252. Scherer, supra note 98, at 704.
scale. Resources are allocated less efficiently when vertical price fixing coaxes new dealers into a market where demand volume has reached its maximum.

C. Vertical Price Fixing and Cartelization

The Sharp Court noted that vertical price fixing could reduce interbrand competition by facilitating cartelization. However, it dismissed the cartelization issue because no evidence demonstrated the cartelizing effects of nonprice restraints. In mischaracterizing the issue as a nonprice restraint, the Court incorrectly disposed of the cartelization issue.

Commentators on both sides of the vertical price fixing debate recognize the dangers that cartelization poses in a vertical price fixing environment. Proponents note, however, that a number of factors mitigate the dangers of cartelization. First, a cartel is difficult to hold together. Cartels are expensive and difficult, if not impossible, to coordinate and police. In addition, if entry into the market is relatively easy, vertical price restraints are unlikely to facilitate cartelization. Thus, a cartel will succeed only in highly concentrated markets where a small number of manufacturers and dealers account for most of the sales in the area.

Proponents also contend that the per se proscriptions against cartelization or price fixing at the manufacturers' or dealers' levels provide adequate protection against cartelizing behavior. As the majority noted in Sharp, antitrust law focuses primarily on interbrand competition, not intrabrand competition. Because the per se proscription against horizontal price fix-

253. Id. at 704-05.
255. Id.
256. Scherer, supra note 98, at 691-92. Proponents have noted this danger. Sharp, 108 S. Ct. at 1520; Posner, supra note 244, at 294; GUIDELINES, supra note 12, at 16-18. Opponents of vertical price fixing have also recognized it. Halverson, supra note 180, at 6466; Pitofsky, supra note 61, at 15-17.
258. Id.
259. GUIDELINES, supra note 12, at 16-18. Entry of new manufacturers and dealers would undermine the cartel by cutting prices. Substitute products also put price pressure on cartels unless the manufacturers of those substitutes also participate in the cartel. Id.
260. Id.
261. Sharp, 108 S. Ct. at 1520. Vertical restraints decrease intrabrand competition by reducing the number of distributors of the same product in a particular location, restricting the customers to whom a dealer may sell, requiring exclusive dealership arrangements, or by fixing the price at which a dealer may resell the product. Proponents contend, however, that interbrand competition provides a significant check on the ability of the manufacturer or dealer to exploit intrabrand market power due to the availability of competitors' products. See Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 54-55 (1977).
ing adequately protects interbrand competition, the per se rule against vertical price fixing is not needed.

Opponents of vertical price fixing find these arguments unpersuasive. In their view, permitting vertical price fixing would facilitate the creation and stabilization of interbrand manufacturer cartels and, thereby, reduce interbrand competition. First, they argue that proponents of vertical price fixing attach too much weight to the assumption that distribution markets are perfectly competitive. In general, interbrand competition is overestimated as a check on cartelization. Brand or product imaging differentiates similar products and reduces competition among these products. Manufacturers may impose nonprice vertical restraints, such as territorial or customer restrictions or exclusive dealing arrangements, which effectively limit the amount of interbrand as well as intrabrand competition. They may likewise terminate dealers for non-compliance with these restraints. All of these factors increase concentration in the market and facilitate cartelization.

Second, if the impetus for an action that promotes vertical price fixing comes from a dealer, it is more likely that the purpose is to suppress price competition, and its effect is to facilitate a cartel. Even proponents of vertical price fixing admit that the imposition of vertical restraints in response to the demands or complaints of dealers is more likely to be anticompetitive and inefficient than those imposed based on the independent judgment of a manufacturer. The manufacturer's independent decision to impose vertical restraints more likely attempts to enhance distributive efficiencies and increase output. Dealers are more concerned with competition and profit margin than with distributive efficiencies, and their complaints about discounting dealers are more likely intended to further a horizontal agreement. Where a complaint results in the termination of a dealer, the restraint takes on the character of a horizontal restraint of trade and should be classified as such regardless of the number of parties involved in the boycott. In determining whether a particular restraint of trade is

262. Gerla, supra note 98, at 18.
263. Id.
264. See, e.g., Pitofsky, supra note 61, at 27-38 (arguing that vertical restrictions other than vertical price fixing can be highly anticompetitive and reduce the ability of discounters to compete); Gerla, supra note 98, at 16, 23-25 (certain vertical restraints are as damaging to competition as vertical price fixing).
265. Campbell & Ware, Russell Stover and the Vertical Agreement Puzzle, 52 Antitrust L.J. 83, 89 (1989); see also Pitofsky, supra note 98, at 1490-91.
267. Id.
268. Campbell & Ware, supra note 265, at 89.
269. Id. at 89.
unreasonable, the substance and effect of the restraint should carry more weight than its form.

Finally, manufacturers organizing and enforcing dealer cartels diminish pressure on their own wholesale prices and therefore, stabilize interbrand manufacturer cartels.\textsuperscript{271} Retail prices are much more visible and public and can be used by manufacturers as a measure of their competitors' compliance with a cartel agreement.\textsuperscript{272} Providing dealers with a guaranteed return reduces the pressure on a manufacturer to lower prices, reduces incentives to become more efficient and, thus, facilitates cartelization and fosters inefficient behavior.\textsuperscript{273} Price competition is reduced and nonprice factors such as services, advertising, and promotion take over, creating an illusion of intense competition.

\section*{V. CONGRESSIONAL PROPOSAL TO CODIFY THE PER SE STANDARD}

Congressional concern about the impact of the \textit{Monsanto} decision on private vertical price fixing actions resulted in the House of Representatives' passage of the Freedom from Vertical Price Fixing Act\textsuperscript{274} of 1987. That same year, the Senate Judiciary Committee passed the Retail Competition Enforcement Act\textsuperscript{275} of 1987 and submitted it to the Senate for approval. Neither bill passed in the 100th Congress, but both were reintroduced in the 101st Congress.\textsuperscript{276} The measure\textsuperscript{277} would amend the Sherman Antitrust Act and, as proposed, would accomplish several purposes.

First, the proposal would codify the per se rule against vertical price fixing. It would make clear that all forms of vertical price fixing are illegal, and evidence of an agreement on a specific price or price levels would not be required to prove a vertical price fixing conspiracy.\textsuperscript{278} Thus, a court would
find a violation of the Sherman Act where a manufacturer and supplier conpired either to fix or maintain prices, to restrict another dealer's ability to determine his resale price, or to terminate or cut off supply to a price-cutter. The proscription would be absolute, covering all activity designed "to restrain price movement and the free play of market forces."

Second, the revised measure would reverse the Monsanto and Sharp evidentiary standard. It would properly return to the trier of fact the task of determining whether a set of facts indicates the existence of concerted action or agreement. Specifically, the jury would determine whether the plaintiff presented sufficient evidence to infer a contract, combination, or conspiracy to set, change, or maintain prices in violation of the Sherman Act. The plaintiff would not be required to present evidence sufficient to show an explicit agreement on prices or price levels in order to reach the jury.

Third, the measure details the type of evidence that would be sufficient to meet the new evidentiary standard; that is, a communication between a manufacturer and a dealer regarding price competition. Under the proposed statute, to reach the trier of fact the plaintiff must show only the existence of price communications. It defines a price communication as any express or implied threat, suggestion, request, or demand from the manufacturer or rival dealer that the plaintiff discontinue price competition. Moreover, the statute would require the plaintiff to show that the termination or refusal to supply was "in response to" such demands or threats from the supplier. A termination "following" a complaint would not imply causation.

policy "recent efforts to qualify, trivialize, or dilute the breadth of the RPM (resale price maintenance) stricture." Id. The new version of section 2 would reverse the impact of the Sharp decision by deeming vertical price fixing agreements illegal per se whether or not a specific price level is agreed upon. See H.R. 1236, 101st Cong., 1st Sess. (1989).

279. H.R. REP. No. 421, supra note 15, at 38. The bill attempts to eliminate the "artful" blurring of the distinction between nonprice and price restraints, currently practiced by some courts and the administration, by concentrating on the purpose and effect of the conduct. Id. at 38-39. That is, if the purpose and effect of the conduct is to stifle price competition in any manner, then vertical price fixing is implicated and the per se rule would apply. Id. at 39.

280. Id. (quoting Cernuto v. United Cabinet Corp., 595 F.2d 164, 169 (3d Cir. 1979)).

281. Id. at 31-32.

282. Id. Communications between manufacturers and dealers concerning price competition that result in the termination of the price cutter, would constitute a sufficient showing of causation to reach a jury. The plaintiff need not disprove that the manufacturer acted independently. Id.

283. See supra note 278.


285. Id. at 34-35.

286. Id. at 31. "In response to" a complaint implies a causal relation to the price communication. Id.

287. Id.
Finally, the plaintiff would be required to convince the trier of fact that these demands or threats were the major or substantial contributing cause of its termination. If such evidence was available, the court would be required to present the issue to the jury.

VI. CONCLUSION

While the Sharp Court left the per se rule against vertical price fixing intact, it continued the trend of the Court's holdings in Sylvania and Monsanto, by narrowing the scope of the absolute prohibitions against vertical restraints. By adopting the Chicago School and Reagan administration position that vertical restraints are procompetitive and efficiency enhancing the Court has effectively repudiated the Congressional position on vertical price fixing, and has quite likely set the stage for overturning Dr. Miles. The Court's commitment to the holding of Dr. Miles appears to rest solely on the doctrine of stare decisis.

The legal and economic impact of Sharp is predictable. Discounters have much less legal protection against collusive termination. Sharp has further reduced the likelihood of bringing a successful vertical price fixing action and, therefore, will result in an increase in dealer terminations.

Economic experience proves that vertical price fixing results in higher prices to the consumer. However, no empirical evidence demonstrates that higher prices result in better sales services. The Sharp decision rests solely on an economic theory propounded by the Chicago School and supported by the Reagan administration. Nothing in the Sharp holding guarantees that the quantity or quality of consumer sales services will improve after Sharp. If a manufacturer determines that the provision of sales services would increase output, a dealer contract would provide a much less restrictive means to secure the services from the retailer. Vertical price fixing is an economically inefficient means of inducing these services and, except for a few well defined exceptions, it is purely a means of transferring wealth from consumers to manufacturers and dealers.

The proposed amendment to the Sherman Act offers the only means of assuring that consumers and discounters will be protected from the real and damaging consequences of a practice affording only illusory benefits. Congress should act to preserve competition that will benefit both consumers

288. Id. at 33. The evidentiary burden has been equated to a "but for" causation test such that de minimis or immaterial causation does not raise an inference. Id. at 33-34.

289. Id. at 32. Such evidence would be sufficient to overcome a motion for summary judgment, directed verdict, or judgment notwithstanding the verdict. However, the defendant is not precluded from submitting evidence that rebuts the plaintiff's evidence and thereby obtain a summary judgment, directed verdict or judgment notwithstanding the verdict. Id. at 32-33.
and manufacturers in the long run by making manufacturers more competitive and efficient. Although antitrust laws protect competition, not competitors, Congress must act to protect a certain class of competitors, the discounters. If no action is taken to protect discounters, competition will certainly be reduced, resulting in higher prices and lower output.

Dennis O. Doherty