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VERTICAL PRICE-FIXING AND THE CONTRACT CONUNDRUM: BEYOND MONSANTO

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INTRODUCTION

In the landmark case of Dr. Miles Medical Co. v. John D. Park & Sons Co., the Supreme Court held that it is a per se violation of Section 1 of the Sherman Act for a manufacturer to agree with a dealer on the dealer's resale price. Although Dr. Miles has stood for seventy-four years, the issue remains ripe for discussion.

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1. 220 U.S. 373 (1911).
2. See infra note 3.

The test of reasonableness, the so-called rule of reason, has its origins in Standard Oil Co. v. United States, 221 U.S. 1, 63-64 (1911). It was described in Justice Brandeis' opinion in Board of Trade v. United States, 246 U.S. 231 (1918):

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. at 238. This statement of the rule of reason has been frequently cited by the Supreme Court. See, e.g., Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 343 (1982); National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 691 (1978).

Per se rules of illegality are applied to "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." Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958); see NCAA v. Board of Regents, 104 S. Ct. 2948, 2962 (1984); Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 350-51 (1982). Under per se analysis, the plaintiff need not prove that defendant's behavior has an anticompetitive effect. See NCAA v. Board of Regents, 104 S. Ct. at 2960. "It is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act." United States v. Topco Assocs., 405 U.S. 596, 607-08 (1972).


5. Dr. Miles, 220 U.S. at 407-09.
years, its per se condemnation of vertical price-fixing\(^6\) is highly controversial.\(^7\) Justice Holmes, dissenting in *Dr. Miles*, stated: "I think that, at least, it is safe to say that the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear."\(^8\) Justice Holmes could find no clear ground for interfering with the freedom of a manufacturer and his retailers to agree on a resale price.\(^9\) Justice Brandeis, although not on the Court at the time *Dr. Miles* was decided, was of a similar view: "[A] right in the individual manufacturer of a competitive business to market his goods in his own way, by fixing, if he desired, the selling price to the consumer, is in entire harmony with the underlying purposes of the Sherman Law."\(^10\) While Holmes' dissent was grounded on a laissez faire philosophy,\(^11\) Brandeis thought vertical price-fixing was compatible with the Sherman Act because it enabled independent retailers to compete more effectively with chain stores.\(^12\)

As has been stated elsewhere, Brandeis and Holmes each "entertained idiosyncratic views outside the mainstream of antitrust development."\(^13\)

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6. Vertical price-fixing is effected when a manufacturer agrees impliedly or explicitly with a distributor, either a wholesaler or a retailer, to set a price at which the goods will be resold. See American Bar Association, Antitrust Law Developments (Second) 56 (2d ed. 1984). For a description of nonprice vertical restriction, see *infra* note 31.


Horizontal price-fixing is effected when price is fixed by competitors on the same distribution level. See American Bar Association, *supra*, at 28-29. Horizontal price-fixing, in most cases, is per se illegal. See Broadcast Music, Inc. v. CBS, 441 U.S. 1, 8 (1979).


9. See id. at 411-12.


11. See M. Handler, Antitrust in Perspective 20 (1957). The laissez faire doctrine has been described as calling for "the limitation of governmental activity to the enforcement of peace and . . . 'commutative justice,' to defense against foreign enemies, and to public works regarded as essential and as impossible or highly improbable of establishment by private enterprise or, for special reasons, unsuitable to be left to private operation." Viner, *The Intellectual History of Laissez Faire*, 3 J.L. & Econ. 45, 45 (1960). Vertical price-fixing could plausibly be viewed as raising an issue of commutative justice—the justice of the system for exchange—and therefore a proper concern of government under the laissez faire doctrine. Others might conceive commutative justice more narrowly.


Nevertheless, the enactment of the Miller-Tydings Act of 193714 was in accord with Brandeis' view of vertical price-fixing as procompetitive.15 The Act created a "fair trade" exception to the Sherman Act16 by allowing a manufacturer who sold goods marked with its trademark, brand, or name which were in "free and open competition" with other commodities of the same general class, to set the retail price for its goods, provided state legislation authorized such resale price maintenance.17 In 1952 the fair trade exception was broadened by adoption of the McGuire Act,18 which exempted from antitrust laws vertical price-fixing agreements that under state law bound not only retailers who were parties to the agreement but also those who were not.19 Thus, if a manufacturer entered into a retail price contract with at least one retailer in a state as authorized by its fair trade statute, that price would automatically apply to all other retailers of the product in the state, even though no other had agreed to the contract price. When the McGuire Act was adopted, forty-five states had such fair trade legislation.20

The "free and open competition" requirement of fair trade legislation recognized an important distinction between intrabrand and interbrand competition.21 While vertical price-fixing is destructive of price competition between sellers of the same brand, it has no necessary impact on price competition between sellers of different brands.22 The Miller-Tydings exemption of vertical price-fixing thus existed only where there was interbrand competition.23 Nonetheless, with the emergence of consumerism in the 1970's, Congress repealed the Miller-Tydings and McGuire

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15. See supra text accompanying note 10.
19. Id. at 632.
20. 1 E. Kintner, supra note 17, at 925.
21. The Supreme Court recently recognized this distinction as one of central importance to antitrust law:
Interbrand competition is the competition among the manufacturers of the same generic product . . . and is the primary concern of antitrust law. The extreme example of a deficiency of interbrand competition is monopoly, where there is only one manufacturer. In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer.
22. See id. ("[W]hen interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product."); see also id. at 51-52 ("The market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition.") (footnote omitted).
23. See supra notes 16-17 and accompanying text.
The Brandeis view that vertical price-fixing would increase inter-brand competition by protecting small family-owned retail outlets was rejected on several grounds. Instead, it was seen as leading to higher prices through the destruction of intrabrand competition.

The current law of vertical price-fixing is essentially where it was in 1934 prior to adoption of the Miller-Tydings Act, i.e., per se unlawful without exception. While the Brandeis view has been thoroughly repudiated, the Holmes view seems to be undergoing revitalization. In 1983,

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25. The Report of the House Committee on the Judiciary stated:

The first difficulty with this argument is that it finds no support in the facts

Second, to the extent the 'Mon [sic] and Pop' retailer charges a higher price because he is providing more services to his customers, consumers should have the freedom to choose between paying more for those services and buying nothing but the unadorned product at a lower price from a competitor . . .

Moreover, there is some evidence that 'fair trade' laws can actually work to stifle market entry to new small retail businesses.

26. See id. at 3 ("From the consumer's point of view, 'fair trade' has one effect—higher prices.").
27. See Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977). Although Dr. Miles is universally recognized as the first case to treat vertical price-fixing as per se illegal, see Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984); California Retail Liquor Dealers Ass'n v. Midcal Aluminium, Inc., 445 U.S. 97, 102-03 (1980); Posner, supra note 6, at 11 n.25, the Dr. Miles Court did not use the term "per se illegality." It was not until after the repeal of the Miller-Tydings and McGuire Acts that the Supreme Court expressly declared that vertical price-fixing was per se illegal. See Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977).

The Justice Department takes the position that the repeal of the Miller-Tydings and McGuire Acts did not imply that Congress viewed vertical price restraints as per se illegal:

There is . . . no necessary incongruity between the action of Congress in repealing the [Miller-Tydings and McGuire Acts] and a rule of reason treatment of [resale price maintenance] under the Sherman Act. The [federal] Fair Trade Laws were far too sweeping a determination of per se legality, and [the Antitrust Division] agree[s] that they ought to have been repealed. In [the Antitrust Division's] judgment, the action of Congress in 1976 [sic] does not preclude the Supreme Court from reaching a conclusion that, although [resale price maintenance] continues to be per se illegal in those contexts in which it might facilitate horizontal collusion, it should be treated under the rule of reason in other contexts. Although both the House and Senate reports indicate awareness that the Supreme Court had previously declared [retail price maintenance] illegal per se and no doubt expected that they were remitting [retail price maintenance] to that status by repealing the [Miller-Tydings and McGuire Acts], it is also true that there is nothing in the legislative history which indicates a congressional disposition to limit the power of the courts to continue, through interpretation, the evolution and adaptation of the Sherman Act in light of the continuing development of microeconomic analysis.

William Baxter, then Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, favored overruling Dr. Miles, "not because it is clearly the right answer in any economic sense, but because I have a strong bias in favor of letting people do whatever they want, at least in the absence of a demonstration that they are imposing harm on someone else . . . ."  

Although the government's current opposition to Dr. Miles's rule of per se illegality may be grounded in laissez faire philosophy, it has a legal basis in the case of Continental T.V., Inc. v. GTE Sylvania Inc. In Sylvania the Court held that nonprice vertical restrictions, which limit

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In Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984), the Court noted: The Solicitor General (by brief only) and several other amici suggest that we take this opportunity to reconsider whether 'contract[s], combination[s], . . . or conspirac[ies]' to fix resale prices should always be unlawful. They argue that the economic effect of resale price maintenance is little different from agreements on non-price restrictions . . . . They say that the economic objections to resale price maintenance that we discussed in Sylvania . . . —such as that it facilitates horizontal cartels—can be met easily in the context of rule-of-reason analysis.

Certainly in this case we have no occasion to consider the merits of this argument. This case was tried on per se instructions to the jury. Neither party argued in the District Court that the rule of reason should apply to a vertical price-fixing conspiracy nor raised the point on appeal. In fact, neither party before this Court presses the argument advanced by amici. We therefore decline to reach the question, and we decide the case in the context in which it was decided below and argued here.

Id. at 761-62 n.7.

After the Justice Department's amicus brief was filed with the Court, Congress attached to an appropriations bill an amendment that prohibited the Justice Department from using any funds to overturn the per se rule. See Related Agencies Appropriations Act, Pub. L. No. 98-166, 97 Stat. 1071, 1102-03 (1983). In its argument before the Court the Justice Department was limited to arguing for an exception to the Dr. Miles rule.

If a supplier adopts a bona fide distribution program that includes nonprice restraints and if that program is reasonably addressed to distribution problems, the case must be judged by the rule of reason unless the plaintiff can show . . . an explicit agreement about the prices distributors are to charge.

See Arguments of the Justice Department in Monsanto Co. v. Spray-Rite Serv. Corp., 52 U.S.L.W. 3448, 3448 (U.S. Dec. 13, 1983) (emphasis in original). Under this rule, Dr. Miles generally would be limited to express price agreements. The Court, however, treated the Justice Department's arguments as if they were a request for the overruling of Dr. Miles. See Monsanto, 465 U.S. at 761-62 n.7.


31. Nonprice vertical restrictions take many forms: [One is] the assignment of exclusive sales territories, which forbid the distributor or dealer to sell outside of a specified territory on pain of having its relationship with the manufacturer terminated or, perhaps, of having to pay a "profit passover" or some other charge to the distributor or dealer whose territory it
where or to whom a dealer may sell, are subject to rule of reason analysis, and overruled United States v. Arnold, Schwinn & Co., which had held them per se unlawful. Because nonprice restrictions such as those that specify the territory in which a dealer may resell his goods have the same purpose and effect as vertical price-fixing—both are designed to increase price and sales by reducing intrabrand competition—the Attorney General claimed both should be subject to the same legal standard.

Furthermore, the Sylvania right of a manufacturer to impose territorial or other nonprice restrictions without running afoul of the per se rule is an empty right, according to former Assistant Attorney General Baxter, because a dealer terminated for violating a nonprice restriction may sue for treble damages claiming he was terminated on account of his pricing practices. Because it may be difficult to prove whether the dealer was terminated for pricing or for other reasons, reliance on Sylvania is a high-risk proposition.

These objections to Dr. Miles raise questions of both practice and theory. At the practical level the question is whether price and nonprice restraints can be distinguished in the real world. If not, Sylvania and Dr. Miles invaded. In addition, there are outlet restrictions, which might forbid a distributor to sell to any dealer not approved by the manufacturer, or forbid one dealer to sell ("bootleg") to another dealer, and location clauses, which forbid a dealer to sell the manufacturer's product at any location other than that specified in the dealership agreement. Sometimes a manufacturer will reserve certain large customers to itself, thus eliminating the competition that might otherwise exist between itself and its dealers. Or it may agree to an exclusive distributorship or dealership, and thereby lose its freedom to authorize additional distributors or dealers that might compete with the one previously authorized.

Posner, supra note 6, at 6-7.


34. See id. at 382. Four years before Schwinn, the Court in White Motor Co. v. United States, 372 U.S. 253 (1963), stated that it was not sufficiently familiar with vertical nonprice restraints to declare them per se illegal. See id. at 261, 263.

35. See Amicus Brief of the United States at 21-22, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) ("Price-related vertical restrictions in general, and resale price maintenance in particular, accomplish directly what nonprice vertical restraints accomplish indirectly: both types of practice are designed to increase both price and sales volume.").

36. See Baxter Letter II, supra note 29, reprinted in Scherer, supra note 29, at 718 ("In short, the per se rule against [resale price maintenance] goes far to subvert, in practice, the rule of reason treatment which is, in theory, accorded to all other vertical distribution controls. So long as manufacturers must abide the outcome of trial before juries . . ., [they] will be strongly deterred not just from entering formal price arrangements, but from resorting to a wide variety of distribution controls."); see also Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 168-69 (3d Cir. 1979) (nonprice restrictions can constitute price-fixing and thus be per se illegal); Baker, Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way Out?, 67 Va. L. Rev. 1457, 1463 (1981) ("Because of the enormous attraction of litigating under a per se rule, virtually every plaintiff now alleges that . . . vertical restrictions are intended to control price."); Posner, supra note 6, at 11 ("Disparate legal treatment of vertical price and nonprice restrictions may, as a practical matter, often result in the condemnation of the latter as per se illegal, contrary to the holding of Sylvania.").
**Miles** require the application of different standards to indistinguishable behavior and the Supreme Court should overrule one or the other.

Assuming the cases are not incompatible in practice, the theoretical question remains: Do vertical restrictions of the price and nonprice variety generally serve the same purpose and produce the same effect? If so, they ought to be subject to the same legal standard. These questions implicate the **Colgate** case, which limits the circumstances under which an agreement to fix resale prices may be inferred.

I. **ARE DR. MILES AND SYLVANIA INCOMPATIBLE IN PRACTICE?**

Is it possible to adhere to the principles of both **Dr. Miles** and **Sylvania**? In the abstract, the answer is self-evident. Vertical restrictions can be divided into two categories, those directly affecting price and those which do not. **Dr. Miles** deals only with the former and **Sylvania** only with the latter. An agreement between a manufacturer and a dealer which imposes a territorial restriction by prohibiting dealer sales outside a specified geographic area has no direct bearing on the price. Its impact on price, if any, is indirect. It may reduce or eliminate competition among dealers handling the manufacturer’s product. The degree to which intrabrand competition is affected depends on the degree of exclusivity granted the dealer. If the territories are not exclusive, intrabrand competition will be reduced but not eliminated. If each dealer is given an exclusive territory, intrabrand competition is eliminated, but the impact on price will depend on the degree of interbrand competition faced by the dealers. A similar agreement providing for resale by the dealer at specified prices, however, directly affects price and would appear to be readily distinguishable from any nonprice restriction.

In practice, this bright line between price and nonprice restrictions disappears because there need not be an express agreement for a violation of the per se rule of **Dr. Miles** to occur. Depending on the standards applied in determining what evidence will support the inference of a vertical price-fixing agreement, the line between price and nonprice restrictions may become too blurry.

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37. Compare Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 69 (1977) (White, J., concurring) (“It is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well.”) with id. at 51 n.18 (pointing out that industry-wide vertical price-fixing might be used to facilitate cartels, a danger not raised by nonprice vertical restrictions).
39. See id. at 306-07.
40. See supra notes 3, 31 and accompanying text.
41. See supra note 22 and accompanying text.
42. See United States v. General Motors Corp., 384 U.S. 127, 142-43 (1966) (“it has long been settled that explicit agreement is not a necessary part of a Sherman Act conspiracy”); American Tobacco Co. v. United States, 328 U.S. 781, 809 (1946) (“No formal agreement is necessary to constitute an unlawful conspiracy.”).
43. See supra note 36 and accompanying text.
Suppose a manufacturer produces widgets packaged for retail sale and marked with a suggested retail price of ten dollars. The manufacturer believes it can maximize sales by reducing competition among retailers and therefore specifies the locations where retailers must sell. The locations are spaced so that, in the manufacturer’s judgment, there will be little or no competition among retailers in the sale of its widgets. Retailer A charges the suggested price of ten dollars on sales at the location specified by the manufacturer. He also decides he could make more money by selling widgets for nine dollars at an unauthorized location in competition with retailer B. Suppose B complains to the manufacturer. Can the manufacturer terminate A because A violated the location restriction—not because of A’s failure to comply with the suggested price—secure in the knowledge that the termination can be defended under the rule of reason? Or would such a termination instead lay the foundation for a treble damage action based on a per se theory of vertical price-fixing?

In this context, most would agree with former Assistant Attorney General Baxter that the per se rule would strongly deter enforcement of the location restriction. This occurs not merely because the manufacturer imposed a location restriction which was violated, but because the restriction was coupled with a suggested retail price which the retailer chose to ignore. Thus, there is evidence suggesting the manufacturer was not totally indifferent concerning retail prices. Had there not been at least some such evidence, the manufacturer could have been reasonably certain that the termination would be tested under the rule of reason.

In addition to the manufacturer’s right under Sylvania to impose non-price restrictions subject to the rule of reason, the manufacturer has the further right under United States v. Colgate & Co. to suggest resale prices and to announce in advance that noncomplying retailers will be terminated. Colgate views this as unilateral action not subject to the Sherman Act. Since unilateral action is not subject to the Sherman Act and territorial restrictions are subject to the rule of reason, it is arguably improper to deter the coupling of these practices through threatened application of the per se rule.

This argument is disingenuous. The manufacturer’s suggestion of a resale price creates the risk that a price-fixing agreement will be inferred. This risk would exist regardless of the territorial restrictions. For instance, if there were no territorial or other nonprice restrictions and re-

44. Location restrictions have generally been upheld under a rule of reason analysis. See, e.g., Continental T.V., Inc. v. GTE Sylvania Inc., 694 F.2d 1132, 1136-40 (9th Cir. 1982); Golden Gate Acceptance Corp. v. General Motors Corp., 597 F.2d 676, 680-81 (9th Cir. 1979).
45. See supra note 36.
46. See supra notes 31-34 and accompanying text.
47. 250 U.S. 300 (1919).
48. See id. at 307.
49. See id.
tailer A were being terminated for failure to meet a sales quota or for any other business reason, the same risk would exist. The problem then is not a new one created by the *Sylvania* decision, but an old one concerning the scope of *Colgate* and when a vertical agreement concerning price should be inferred.

*Dr. Miles* and *Sylvania* address restrictions reasonably distinguishable and it is rational to adhere to both decisions. The existing uncertainty can be attributed directly to *Colgate* and the distinction of independent from concerted action. There is an obvious and long recognized tension between *Dr. Miles*, which flatly prohibits a manufacturer and its dealers from agreeing to a resale price, and *Colgate*, which permits a manufacturer to "suggest" a resale price which may be disregarded by dealers only on pain of termination.50

Baxter believes this tension and the resulting ambiguity should be resolved by overruling *Dr. Miles*.51 This would make clear that a manufacturer can impose any vertical restraint without fear of a per se violation. It is also arguable, however, that the law should be clarified by overruling *Colgate*. The choice of which case to overrule should be made by examining the interests served by each. After examining the role of *Colgate* in antitrust analysis of vertical price-fixing and its impact on *Dr. Miles*, this Article will examine the economic purpose and effect of vertical price-fixing.

II. THE PURPOSE AND EVOLUTION OF THE COLGATE DOCTRINE

A. The Colgate Case

The foundation for *Colgate* was laid in *Dr. Miles*. In explaining why it is unlawful for a manufacturer to fix retail prices, the Court in *Dr. Miles* stated:

If there be an advantage to a manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell. As to this, the complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agree-

50. See United States v. A. Schrader's Son, Inc., 264 F. 175, 183 (N.D. Ohio 1919) ("Personally, and with all due respect, permit me to say that I can see no real difference upon the facts between the Dr. Miles Medical Co. Case and the Colgate Co. Case. The only difference is that in the former the arrangement for marketing its product was put in writing, whereas in the latter the wholesale and retail dealers observed the prices fixed by the vendor. This is a distinction without a difference. The tacit acquiescence of the wholesalers and retailers in the prices thus fixed is the equivalent for all practical purposes of an express agreement . . . "). rev'd, 252 U.S. 85 (1920); Calvani & Berg, *Resale Price Maintenance After Monsanto: A Doctrine Still at War with Itself*, 1984 Duke L.J. 1163, 1168-69 ("distinction between unilateral action and concerted conduct [is] of uncertain precedential value.")

51. See *supra* notes 28-29 and accompanying text.
This language presents two distinct reasons justifying the per se rule against vertical price-fixing. First, vertical price-fixing restricts dealers' freedom to trade. Second, it produces uniform pricing among dealers and thus has the same effect as horizontal price-fixing at the dealer level. The opinion is not entirely clear on whether either reason standing alone would justify condemnation. This point is important because the reasons suggest different notions concerning the goals of antitrust. The freedom to trade rationale reflects social or political values as well as economic ones. The horizontal effect rationale reflects only economic values. It is generally recognized that the Sherman Act was intended to achieve economic goals such as low prices and high output, but sharp disagreement exists concerning whether Congress had additional objectives. Since the Sherman Act is based on the proposition that economic goals are most effectively achieved through a competitive system dependent on free pricing among competitors, horizontal price-fixing which eliminates free pricing is appropriately subject to the per se rule. If there were general agreement that vertical price-fixing has the same purpose and effect as horizontal price-fixing, the rule of Dr. Miles would

52. Dr. Miles, 220 U.S. at 407-08.
53. Elsewhere in the Colgate opinion, the Court stated:
   In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.
Colgate, 250 U.S. at 307.
54. See supra note 6.
55. See Dr. Miles, 220 U.S. at 406.
56. See id. at 408 (result of identical vertical contracts is same as horizontal combination—uniform prices).
59. See NCAA v. Board of Regents, 104 S. Ct. 2948, 2962 n.27 (1984) (“The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.”) (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958)).
60. See H. Hovenkamp, supra note 57, at 91 (“[A]s long as firms are tempted to fix prices, the strong policy against cartels in the American antitrust laws is a good one.”). See supra note 6.
not be controversial. Since the two forms of price-fixing are now widely believed to serve different purposes and to produce different effects, and since many believe social or political values have no place in antitrust, it is not surprising that Dr. Miles has been questioned.

In Colgate the manufacturer informed its wholesale and retail customers that it would continue to deal only with those customers who resold at the established prices. The Court recognized that:

The retailer, after buying, could, if he chose, give away his purchase, or sell it at any price he saw fit, or not sell it at all; his course in these respects being affected only by the fact that he might by his actions incur the displeasure of the manufacturer, who could refuse to make further sales to him, as he had the undoubted right to do.

Dr. Miles was distinguished as involving "contracts which undertook to prevent dealers from freely exercising the right to sell." In what have become household words to antitrust lawyers, the Court announced that:

In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.

This result was justified, said the Court, because the "purpose of the Sherman Act is . . . in a word to preserve the right of freedom to trade."

The freedom to trade concept proved to be a double-edged sword in Colgate. While it assured the dealer freedom to price goods as he saw fit, it also assured the manufacturer's right to refuse to deal with distributors who in the past had declined to price the product in accord with the manufacturer's expectations. Essentially, the Court was forced to choose between the two rationales of Dr. Miles. In Dr. Miles, the freedom to trade and horizontal effect rationales both supported a determination of illegality. In Colgate, the rationales pointed in opposite directions. The

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61. See infra Part III.
63. Colgate, 250 U.S. at 303.
64. Id. at 306 (quoting United States v. Colgate & Co., 253 F. 522, 527 (E.D. Va. 1918), aff'd, 250 U.S. 300 (1919)).
65. Colgate, 250 U.S. at 307-08.
66. Id. at 307.
67. Id.
68. See supra notes 52-56 and accompanying text.
freedom to trade rationale suggested that a manufacturer also should be free to select with whom it will deal, but the horizontal effect rationale suggested that customer selection used as a device to bring about uniform resale pricing undermines intrabrand competition and violates the Sherman Act. The Colgate court rejected the horizontal effect rationale of Dr. Miles by ignoring it. The manufacturer’s refusal to deal with distributors who, in the past, had not followed suggested retail prices, was upheld because it involved nothing more than an exercise of the manufacturer’s freedom to trade.

Colgate thus elevated noneconomic goals embodied in the freedom to trade concept over the economic goals of the horizontal effect rationale. Furthermore, Colgate is based on an extremely formalistic distinction amounting to the following: If a dealer bought one hundred widgets from a manufacturer and agreed to resell them at ten dollars each, the agreement infringed his freedom to trade and violated the Sherman Act under Dr. Miles. If the same dealer purchased one hundred widgets being informed by the manufacturer of a suggested resale price of ten dollars and being further informed that the manufacturer would not sell additional widgets to the dealer if the suggested price were not followed, then, under Colgate, the dealer’s freedom to trade was not infringed and no violation occurred. It does not matter that the dealer will resell the widgets at ten dollars only because he wishes to buy additional widgets from the manufacturer.

B. Interpreting Colgate

Not surprisingly, Colgate created confusion. One interpretation, that Dr. Miles barred only express agreements fixing resale prices, was promptly rejected by the Supreme Court. Once it was clear that Dr. Miles applied to implied agreements despite Colgate, attention was focused on what kind of evidence would support a finding of an implied agreement.

The issue was first addressed in FTC v. Beech-Nut Packing Co. Beech-Nut issued lists of suggested retail prices for wholesalers and retailers. To secure compliance, it refused to deal with noncomplying customers and requested that complying customers not resell to them. Furthermore, a customer that had been terminated for failure to resell at suggested price would be reinstated after giving adequate assurance to

69. See Colgate, 250 U.S. at 307 (The Sherman Act “does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”).
70. See supra notes 52–54 and accompanying text.
72. See id. at 307.
73. See Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208, 210 (1921).
74. 257 U.S. 441 (1922).
75. Id. at 447.
76. Id. at 447–48.
Beech-Nut that future sales would be at the suggested prices.\textsuperscript{77}

The lower court held the Beech-Nut practice consistent with the policy of the Sherman Act,\textsuperscript{78} reasoning that, as in \textit{Colgate}, wholesalers and retailers were free to sell their goods at any price they chose, subject only to the possibility of termination if they failed to sell at the suggested prices.\textsuperscript{79} The Supreme Court reversed, observing: "The facts found show that the Beech-Nut system goes far beyond the simple refusal to sell goods to persons who will not sell at stated prices, which in the \textit{Colgate Case} was held to be within the legal right of the producer."\textsuperscript{80} Beech-Nut thus confined the shelter of \textit{Colgate} to mere refusals to deal. If the manufacturer went further and enlisted wholesalers or retailers to aid in enforcing suggested resale prices or solicited assurances of compliance, an agreement in violation of the Sherman Act would be inferred. In limiting \textit{Colgate}, the Beech-Nut Court observed that under the Beech-Nut plan, "competition among retail distributors is practically suppressed; for all who would deal in the company's products are constrained to sell at the suggested prices."\textsuperscript{81} Thus, the Court may be viewed as having done either or both of two things. It may have balanced the manufacturer's freedom to trade against the distributor's freedom to trade and concluded that once the manufacturer passes beyond a mere refusal to deal, his conduct should be characterized as an impermissible infringement on the distributor's freedom. Alternatively, the case can be viewed as revitalizing the horizontal effect rationale of \textit{Dr. Miles}.\textsuperscript{82} Under this second view, the Court found the horizontal effect rationale of \textit{Dr. Miles} more persuasive than the freedom to trade rationale, and \textit{Colgate} was limited to its special facts.\textsuperscript{83}

\textit{United States v. Parke, Davis & Co.}\textsuperscript{84} involved facts similar to those of Beech-Nut. Parke, Davis published suggested retail prices for wholesalers and retailers and announced a policy of selling only to customers who resold at the suggested prices.\textsuperscript{85} It also told wholesalers that it would refuse to sell to those who sold Parke, Davis products to noncomplying

\begin{itemize}
\item \textsuperscript{77} \textit{Id.} at 449.
\item \textsuperscript{78} \textit{See} Beech-Nut Packing Co. v. FTC, 264 F. 885, 889 (2d Cir. 1920), \textit{rev'd}, 257 U.S. 441 (1922). The Beech-Nut selling system was challenged as an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1982), on the theory that any practice contrary to the policy of the Sherman Act was subject to condemnation under Section 5 of the FTC Act. \textit{See} Beech-Nut, 257 U.S. at 453-54.
\item \textsuperscript{79} \textit{Beech-Nut}, 264 F. at 891-92.
\item \textsuperscript{80} \textit{Beech-Nut}, 257 U.S. at 454.
\item \textsuperscript{81} \textit{Id.} at 455.
\item \textsuperscript{82} \textit{See supra} notes 52-54 and accompanying text.
\item \textsuperscript{83} Although the record in \textit{Colgate} indicated that it too had received assurances of compliance from wholesale and retail customers, \textit{see} \textit{Colgate}, 250 U.S. at 303, the Court in \textit{Beech-Nut} explained that the \textit{Colgate} decision was based on the district court's construction of the indictment to accuse the manufacturer merely of refusing to deal. \textit{See} \textit{Beech-Nut}, 257 U.S. at 451-52.
\item \textsuperscript{84} 362 U.S. 29 (1960).
\item \textsuperscript{85} \textit{Id.} at 31-32.
\end{itemize}
The wholesalers indicated a willingness to comply, as did at least one retailer. The district court found no violation of the Sherman Act because Parke, Davis' actions "were properly unilateral" under Colgate.

In reversing, the Supreme Court relied heavily on Beech-Nut, observing that the situation there bore a "marked resemblance to the Parke, Davis program." In explaining the scope of Colgate, the Parke, Davis Court stated that Colgate teaches that judicial inquiry is not to stop with a search of the record for evidence of purely contractual arrangements. The Sherman Act forbids combinations of traders to suppress competition. True, there results the same economic effect as is accomplished by a prohibited combination to suppress price competition if each customer, although induced to do so solely by a manufacturer's announced policy, independently decides to observe specified resale prices. So long as Colgate is not overruled, this result is tolerated but only when it is the consequence of a mere refusal to sell in the exercise of the manufacturer's right "freely to exercise his own independent discretion as to parties with whom he will deal."

This language suggested a distinction between an agreement, express or implied, and a combination to fix resale prices. While the significance of this distinction is not entirely clear, it was clear after Parke, Davis, if

86. Id. at 33.
87. Id. at 33, 35.
89. See Parke, Davis, 362 U.S. at 40.
90. Id. at 44 (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919)). United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944) involved a marketing arrangement similar to that of Beech-Nut. Bausch & Lomb manufactured lenses for sale to Soft-Lite Lens Company which in turn sold to wholesalers throughout the country. Id. at 710. Soft-Lite published a list of wholesale prices and did not deal with wholesalers who deviated from the list price. Id. at 715. Copies of the list were provided to retailers approved by Soft-Lite who also were subject to resale price restrictions. Id. at 715. In finding an unlawful conspiracy under the Sherman Act, the Court stated: "As in the Beech-Nut case, there is more here than mere acquiescence of wholesalers in Soft-Lite's published resale price list. The wholesalers accepted Soft-Lite's proffer of a plan of distribution by cooperating in prices, limitation of sales to and approval of retail licensees. That is sufficient." Id. at 723.

91. A bilateral agreement in the context of contract law generally requires that each party promise performance and thereby create in the other party a right to such performance. See J. Calamari & J. Perillo, The Law of Contracts § 2-14, at 54 (2d ed. 1977). In the context of vertical price-fixing this would occur if, in consideration for the manufacturer's promise to sell, a dealer made an express or implied promise to resell at a specified price.

92. Perhaps the Court meant the term "contract" in Section 1 should be construed in light of the purpose of the Sherman Act rather than according to principles of contract law. Compare Baker, supra note 36, at 1482 (Sherman Act need not follow contract law in definition of "agreement") with Turner, The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal, 75 Harv. L. Rev. 655, 686-87 (1962) (criticism of Court's interpretation of "agreement" requirement because it makes no sense under contract law).
not before, that the Court reversed the relative importance of the freedom to trade and horizontal effect rationales under *Colgate*, leaving no doubt that if it were writing on a clean slate *Colgate* would not be followed. It accomplished this by limiting *Colgate* to situations in which a manufacturer announces a policy of selling only to customers who comply with suggested resale prices, and compliance occurs in response to such announcement. Inference of a combination from these facts would have overruled *Colgate*. Unwilling to go that far, the Court held that if customers are unresponsive to the announcement, the manufacturer may decline to make further sales but may do nothing more to achieve compliance.

Eight years later, the Court, in *Albrecht v. Herald Co.*, addressed whether a newspaper publisher engaged in vertical price-fixing by terminating a distributor who charged more than the maximum prices announced by the publisher. The Court found a combination among the publisher, a third party whom the publisher had hired to solicit customers served by the noncomplying distributor, and another third party who replaced the noncomplying distributor. Both third parties, the Court observed, were aware that they were engaged by the publisher in order to force the distributor to comply with the publisher's suggested price and were therefore part of an unlawful combination. The Court added that even if no third parties had been involved,

[u]nder Parke, Davis, [the distributor] could have claimed a combination between [the publisher] and himself, at least as of the day he unwillingly complied with [the publisher's] advertised price. Likewise, he might successfully have claimed that [the publisher] had combined with other carriers because the firmly enforced price policy applied to all carriers, most of whom acquiesced in it.

93. See supra notes 81-83 and accompanying text.
94. See *Parke, Davis*, 362 U.S. at 44.
95. *Id.*
97. *Id.* at 151-53.
98. Drawing on *Parke, Davis* the Court stated:

[On the undisputed facts . . . respondent's conduct cannot be deemed wholly unilateral and beyond the reach of § 1 of the Sherman Act. That section covers combinations in addition to contracts and conspiracies, express or implied. The Court made this quite clear in United States v. Parke, Davis and Co., where it held that an illegal combination to fix prices results if a seller suggests resale prices and secures compliance by means in addition to the "mere announcement of his policy and the simple refusal to deal . . ." Parke, Davis had specified resale prices for both wholesalers and retailers and had required wholesalers to refuse to deal with noncomplying retailers. It was found to have created a combination "with retailers and the wholesalers to maintain retail prices . . ." The combination with retailers arose because their acquiescence in the suggested prices was secured by threats of termination; the combination with wholesalers arose because they cooperated in terminating price-cutting retailers.]

99. *Id.* at 149 (citations omitted).
100. *Id.* at 147-48.
101. *Id.* at 150 n.6. Similar dicta appeared in *Perma Life Mufflers, Inc. v. Interna-
This language seems to go beyond *Parke, Davis* by allowing a fact-finder to infer from an announced termination policy that a dealer has been coerced into complying with suggested prices. Coerced compliance was viewed as concerted rather than independent action and thus produced the necessary combination.\(^1\) This theory of combination was applied in *Yentsch v. Texaco, Inc.*\(^2\) The plaintiff, a filling station operator who had been terminated by Texaco, testified that the Texaco sales supervisor told him at least ten times during 1971: “Either drop the price or we are going to get a replacement for you.”\(^3\) In upholding judgment for the plaintiff, the Second Circuit stated: “Texaco went beyond Colgate’s safe harbor of announcement plus mere refusal to deal by creating a coercive business climate in which its dealers knew of the low price policy, understood the consequences of failure to comply and thus generally complied.”\(^4\) Significantly, *Yentsch* involved more than mere announcement and termination. Through repeated threats of termination Texaco had created a “coercive business climate.”

In *Russell Stover Candies, Inc.*,\(^5\) the Commission took the step previewed by the dicta of *Albrecht*. It held that Russell Stover violated the Sherman Act because its announced policy of not dealing with purchasers who failed to comply with suggested resale prices led to coerced compliance and thus to a vertical price-fixing agreement.\(^6\) It stated:

> We conclude that the Colgate doctrine as it stands today does not preclude, as a matter of law, a finding of agreement when a buyer unwillingly complies with the supplier’s pricing policies in order to avoid termination. There is no basis, either in legal precedent or theory, for reaching the illogical result that his conduct is only unilateral.\(^7\)

Although the Commission’s decision was reversed by the Court of Appeals for the Eighth Circuit,\(^8\) these post-Parke, Davis decisions raised

\(^1\) Id.
\(^2\) 630 F.2d 46, 52-53 (2d Cir. 1980).
\(^3\) Id. at 50.
\(^4\) Id. at 53.
\(^5\) 1979-1983 Trade Reg. Repts. (CCH) § 21,933 (July 1, 1982), rev’d sub nom. Russell Stover Candies, Inc. v. FTC, 718 F.2d 256 (8th Cir. 1983).
\(^6\) See id. at 22,369.
\(^7\) Id.
\(^8\) See Russell Stover Candies, Inc. v. FTC, 718 F.2d 256 (8th Cir. 1983). The court stated:

> It may be that . . . Albrecht foreshadows the Supreme Court’s overruling of Colgate or it may be, as the Commission suggests, that the Court has already confined Colgate to willing compliance with suggested prices and to initial cus-
serious questions concerning Colgate. The Supreme Court in Monsanto Co. v. Spray-Rite Service Corp.,\textsuperscript{109} however, showed renewed interest in the vitality of Colgate.

C. The Monsanto Case

Spray-Rite sued under the Sherman Act after having been terminated as a distributor of Monsanto products.\textsuperscript{110} Prior to the termination Monsanto had received complaints from other distributors concerning Spray-Rite's failure to comply with Monsanto's suggested prices.\textsuperscript{111} The case was tried to a jury which found that Monsanto and the complaining distributors had agreed to fix the resale price of Monsanto products and the termination occurred pursuant to that agreement.\textsuperscript{112} Spray-Rite was awarded treble damages of $10.5 million.\textsuperscript{113} The Court of Appeals for the Seventh Circuit affirmed,\textsuperscript{114} observing that the record clearly established numerous complaints from competing distributors about Spray-Rite's price-cutting practices.\textsuperscript{115} Although the circuits were divided on whether evidence of price complaints coupled with termination in response to those complaints would support the inference of a resale price maintenance agreement,\textsuperscript{116} the Seventh Circuit held such evidence sufficient.\textsuperscript{117}


\textsuperscript{110} Id. at 757.

\textsuperscript{111} Although Monsanto merely failed to renew Spray-Rite's distributorship, the Seventh Circuit treated the failure to renew as termination. See Spray-Rite Serv. Corp. v. Monsanto Co., 684 F.2d 1226, 1233 n.2 (7th Cir. 1982), aff'd, 465 U.S. 752 (1984).

\textsuperscript{112} Id.

\textsuperscript{113} Id. at 758.

\textsuperscript{114} Id.


\textsuperscript{117} See Monsanto, 684 F.2d at 1238. There was some ambiguity in the Seventh Circuit's opinion on whether the evidentiary standard for finding concerted action required proof of termination in response to competing distributors' complaints, see id. at 1239, or merely that termination followed such complaints, see id. at 1239. On review, the
On review, the Supreme Court rejected the Seventh Circuit's standard of proof but affirmed the judgment\(^\text{118}\) because the evidence satisfied the more stringent standard adopted by the Court.\(^\text{119}\) The Court stated:

\[\text{[I]t is of considerable importance that independent action by the manufacturer, and concerted action on nonprice restrictions, be distinguished from price-fixing agreements, since under present law the latter are subject to per se treatment and treble damages . . . . If an inference of [a vertical price-fixing] agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in Sylvania and Colgate will be seriously eroded.}\(^\text{120}\)

Evidence of price complaints, or even of termination "in response to" complaints was viewed as ambiguous because such complaints are natural reactions by distributors to the activities of rivals.\(^\text{121}\) To preclude a dealer termination merely because the manufacturer is acting on information which originated as a price complaint "would create an irrational dislocation in the market."\(^\text{122}\) Presumably this is because the mere fact that termination is based on information received through dealer complaints does not negate the possibility, indeed the probability, that the manufacturer is freely choosing to terminate the price cutter in its own self-interest rather than acquiescing in the request for help implicit in the complaints. Manufacturers ought to be free to make unilateral business decisions based on relevant economic data regardless of its source.

Stated affirmatively, the Monsanto standard requires the plaintiff to present evidence which reasonably tends to prove that the manufacturer and complaining dealers "had a conscious commitment to a common scheme designed to achieve an unlawful objective."\(^\text{123}\) While evidence of dealer complaints has probative value, there must be evidence which "tends to exclude the possibility of independent action by the manufacturer."\(^\text{124}\) In other words, the evidence must show that the manufacturer was not making a unilateral decision about how to effectively distribute its product, but instead was carrying out the termination because of its agreement with complaining dealers. In Monsanto, this was shown by evidence that Monsanto had approached two price-cutting dealers and advised that if they deviated from suggested prices they would not receive adequate supplies.\(^\text{125}\) At least one dealer informed Monsanto it

\(^{118}\) Monsanto, 465 U.S. at 758 n.4.

\(^{119}\) Id. at 769. Justice Brennan concurred in the opinion. Id.

\(^{120}\) Id. at 765.

\(^{121}\) Id. at 762-63.

\(^{122}\) Id.

\(^{123}\) Id. (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980), cert. denied, 451 U.S. 911 (1981)).

\(^{124}\) Id.

\(^{125}\) Id. at 765.
would comply. "Evidence of this kind," said the Court, "plainly is relevant and persuasive as to a meeting of the minds." Other evidence considered by the Court included a newsletter from a distributor to his dealer-customers which stated:

[W]e are assured that Monsanto's company-owned outlets will not retail at less than their suggested retail price to the trade as a whole. Furthermore, those of us on the distributor level are not likely to deviate downward on price to anyone as the idea is implied that doing this possibly could discolor the outlook for continuity as one of the approved distributors during the future upcoming seasons.

This newsletter, the Court concluded, could be viewed as referring to an agreement that Monsanto would not undercut retail prices and would terminate customers who did. Mere action and reaction in the form of suggested prices and voluntary dealer compliance will not support an inference of concerted action under any of the decided cases. Similarly, Monsanto holds that action and reaction will not support an inference of concerted action where the roles are reversed, that is, where action is by the dealers in the form of complaints concerning prices charged by a competing dealer, and reaction is by the manufacturer in the form of terminating the target of the complaints. Here too there must be some additional evidence tending to exclude the possibility of independent action.

This appears to be a logical and proper application of the Section 1 contract requirement. A manufacturer can suggest resale prices and in response dealers can voluntarily comply without creating the risk of a per se violation. It logically follows that termination in response to dealer complaints should be viewed similarly. In either case, the reaction could plausibly be attributable to an independent choice. Of course, it is equally plausible that the action-reaction was consensual and that the reaction constituted an assent to the request implicit in the action and thus there was a meeting of the minds. So long as either explanation is plausible, the inference of concerted action is speculative and it is appropriate to require additional evidence. The additional evidence which satisfied the court in Monsanto was similar to that involved in Yentsch v.

126. Id.
127. Id.
128. Id. at 766.
129. Id. Monsanto subsequently wrote the distributor who had authored the newsletter urging him to "correct immediately any misconceptions about Monsanto's marketing policies," and disavowing any intent to enter into an agreement on resale prices. Id. at 766-67 n.11. Whether this evidence should give rise to the inference of an agreement, the Court said, was properly left to the jury. Id.
130. See supra note 4.
131. In Monsanto, the Court quoted with approval from an earlier decision: "[Circumstances must reveal] a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement." Id. at 764 (quoting American Tobacco Co. v. United States, 328 U.S. 781, 810 (1946)).
Texaco\textsuperscript{132} and other pre-Monsanto cases.\textsuperscript{133} The Monsanto Court observed in a footnote that “[t]he jury could have concluded that Monsanto sought this agreement [to comply with suggested prices] at a time when it was able to use supply as a lever to force compliance.”\textsuperscript{134} At the same time it flatly stated that under Colgate “a distributor is free to acquiesce in the manufacturer’s demand [concerning resale prices] in order to avoid termination.”\textsuperscript{135} Thus the Court retained the fine, perhaps meaningless, distinction of earlier decisions that allows dealer compliance brought about by the manufacturer’s announcement of a termination policy but disallows dealer compliance brought about through threats of termination or other coercive practices.\textsuperscript{136}

The Monsanto decision may lead to a new equally fine distinction. Arguably, termination in response to dealer complaints should support an inference of concerted action when it occurs in the context of suggested resale prices coupled with an announced refusal to sell to noncomplying dealers. Although suggested prices were involved in Monsanto, there was no announced policy of terminating noncomplying dealers.\textsuperscript{137} The Court may have rejected the Seventh Circuit’s standard of proof because it applied regardless of an announced termination policy.\textsuperscript{138}

While the Monsanto Court did not explicitly recognize this distinction, it is entirely consistent with what the court did say: “‘[T]o permit the inference of concerted action on the basis of receiving complaints alone and thus to expose the [manufacturer] to treble damage liability would both inhibit management’s exercise of independent business judgment and emasculate the terms of the [Act].’ . . . Thus something more than evidence of complaints is needed.”\textsuperscript{139} The manufacturer’s initial suggestion of resale prices coupled with an announced termination policy should satisfy this “something more” requirement. A three-step scenario which involves (1) the manufacturer’s announcement that it will not sell to dealers who fail to sell at the suggested price, (2) dealer complaints of noncompliance by other dealers and (3) termination of noncomplying dealers, indicates “a unity of purpose or a common design and under-

\textsuperscript{132} See supra notes 102-04 and accompanying text.

\textsuperscript{133} See supra notes 74-90 and accompanying text.

\textsuperscript{134} Monsanto, 465 U.S. at 765 n.10.

\textsuperscript{135} Id. at 761.

\textsuperscript{136} See supra text accompanying notes 102-04.

\textsuperscript{137} See Monsanto, 465 U.S. at 756-57, 765-66.

\textsuperscript{138} In one case cited by the Monsanto Court, an agreement was inferred from evidence of termination in response to dealer complaints even in the absence of manufacturer suggested prices. See id. at 759 n.5 (citing Battle v. Lubrizol Corp., 673 F.2d 984, 990-92 (8th Cir. 1982), cert. denied, 466 U.S. 93 (1984)). The Court’s failure to consider the possibility that Monsanto adopted an unannounced, but well known termination policy is not surprising, because there was stronger evidence of concerted action. Not only did Monsanto suggest resale prices, it met with dealers and secured assurances of compliance. Id. at 765.

\textsuperscript{139} Id. at 764 (quoting Edward J. Sweeney & Sons v. Texaco, Inc., 637 F.2d 105, 111 n.2 (3rd Cir. 1980), cert. denied, 451 U.S. 911 (1981)).
standing, or a meeting of minds,” which makes unilateral action unlikely if not totally implausible. Allowing the inference of an agreement from these facts should create little risk that truly independent action would be erroneously characterized as concerted. Risk of error led the Monsanto Court to rule as it did. Where the risk does not exist, or is relatively minor, the Monsanto decision should not preclude inferring an agreement.

Viewed this way, Monsanto falls into the pattern of prior Supreme Court decisions interpreting Colgate. There is a suggestion in the Monsanto opinion, however, that the Court intended to break rather than continue that pattern. The Court expressed concern that under the evidentiary standard applied by the lower court, the “doctrines enunciated in Sylvania and Colgate will be seriously eroded.” This sharply contrasts with the statement in Parke, Davis that

[s]o long as Colgate is not overruled, [resale price maintenance induced by a manufacturer’s announced policy] is tolerated but only when it is the consequence of a mere refusal to sell in the exercise of the manufacturer’s right “freely to exercise his own independent discretion as to parties with whom he will deal.”

Eroding Colgate to strengthen the per se rule of Dr. Miles was viewed as appropriate in Parke, Davis; in Monsanto it was not. This suggests that the foregoing interpretation of Monsanto may be unpersuasive and the decision in fact signals a new and expansive view of Colgate which, according to the Court in Monsanto, is necessary to preserve the integrity of the price/nonprice distinction recognized in Sylvania.

D. Colgate and the Price/Nonprice Vertical Restriction Distinction

In light of Colgate’s progeny, the Monsanto Court correctly emphasized the need to clarify the distinction between independent and concerted action. It also correctly emphasized the significance of the distinction between price and nonprice vertical restrictions, because under Sylvania, per se treatment applies to the former but not the lat-

140. Id. (quoting American Tobacco Co. v. United States, 328 U.S. 781, 810 (1946)).
141. In elaborating on its standard of proof the Court said: “It means... that evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer.” Id. at 810 n.9. Announcement of a termination policy clearly communicates to dealers the manufacturer’s desire for resale price uniformity. A complaint from a complying dealer concerning noncompliance by another dealer clearly communicates the dealer’s acquiescence.
142. See supra notes 118-23 and accompanying text.
143. See supra Part II.B.
144. Monsanto, 465 U.S. at 763.
146. See supra text accompanying notes 91-95.
147. 465 U.S. at 763.
148. See supra notes 18-22 and accompanying text.
149. See supra note 44 and accompanying text.
The Court failed, however, to distinguish the agreement issue from the characterization issue. *Colgate* involved an issue anterior to the price/nonprice distinction. Only after it is determined that concerted action exists does the question of its character as a price or nonprice restriction arise.

Once the agreement issue is isolated from the characterization issue, *Colgate* is readily seen as incompatible with *Sylvania*. *Sylvania* criticized earlier decisions based on abstract formal distinctions rather than economic realities.151 *Colgate* conditions application of Section 1 on just such a distinction: A manufacturer may refuse to sell to a dealer who fails to follow suggested prices, but may not sell to a dealer on condition that the dealer resell at specified prices. Few would argue that this distinction is based on economic or business realities that justify withholding or applying Section 1 liability, or that it clarifies the distinction between independent and concerted action. Furthermore, *Colgate* was based on the freedom to trade notion,152 a discredited theory which, according to *Sylvania*, should be preempted as a factor in antitrust analysis by a market impact test.153 *Colgate* has never made sense except as a device for contracting and expanding the rule of *Dr. Miles*,154 and has obfuscated rather than clarified the question of what constitutes concerted action. The *Monsanto* Court could have substantially clarified the distinction between, independent and concerted action by overruling *Colgate*.

Why did it instead express concern for the erosion of *Colgate*? Perhaps the answer lies in the Court’s obvious disenchantment with the per se rule of *Dr. Miles*.155 The temptation to narrow the scope of *Dr. Miles* by expanding *Colgate* may seem irresistible. That cannot be done, however, without eroding Section 1’s application to nonprice restrictions, i.e., without eroding *Sylvania*. For example, under an expansive reading of *Colgate* a supplier could avoid the rule of reason which *Sylvania* applies to territorial restrictions by suggesting dealers confine their sales to specified territories, by announcing its intentions to terminate dealers not complying with such restrictions and by terminating noncomplying dealers in response to complaints from complying dealers. Conduct which in reality may well involve an agreed-on nonprice restriction and therefore

150. See supra notes 30-31 and accompanying text.
152. See supra text accompanying note 13.
153. See *Sylvania*, 433 U.S. at 57-58; see also *Monsanto*, 465 U.S. at 762 (“the legality of arguably anticompetitive conduct should be judged primarily by its market impact”).
154. This point can be readily grasped if one assumes vertical price-fixing is as damaging to competition as horizontal price-fixing. Plainly, *Colgate* would provide a means for circumventing the rule and would therefore not be tolerated.

Concerning the distinction between vertical price and nonprice restrictions the *Monsanto* Court stated: “[T]he economic effect of all of the conduct described above—unilateral and concerted vertical price-setting, agreements on price and nonprice restrictions—is in many, but not all, cases similar or identical.” *Monsanto*, 465 U.S. at 762.
155. See id. at 761-62.
ought to be subject to the market impact test, as a matter of law is regarded as independent action free from the constraints of Section 1.

A more likely explanation is that when the Monsanto Court expressed concern about the erosion of Colgate it simply wished to emphasize that concerted action is central to Section 1 analysis and should not be lightly inferred. In this context it meant concerted action should not be lightly inferred from a manufacturer's mere suggestion of a resale price, dealer complaints, and a responsive termination. The opinion contains support for this interpretation: "To bar a manufacturer from acting solely because the information upon which it acts originated as a price complaint would create an irrational dislocation of the market."^156

Once a vertical agreement is found, its characterization as a price or nonprice restriction is problematic only if Dr. Miles is of questionable validity. Although there is always some risk a nonprice agreement will be erroneously characterized as a price agreement, that does not mean the distinction should be abandoned. For example, even though an agreement among competitors to exchange price information may erroneously be characterized as a horizontal price-fixing agreement, that risk of error has not led the Court to adopt a special evidentiary standard for finding an agreement in this context or to abandon the per se rule.\(^\text{157}\) The benefits associated with the per se rule against horizontal price-fixing justify the costs associated with the risk of error.\(^\text{158}\)

The same analysis applies to vertical agreements. If Dr. Miles is right, i.e., if vertical price-fixing, like horizontal price-fixing, is nearly always anticompetitive, the risk that some nonprice vertical restrictions may be deterred is acceptable. If incorrect it should be overruled rather than artificially narrowed through Colgate's evidentiary standard exalting form over substance. As the Court has recognized at least since Parke, Davis, the fate of Dr. Miles should depend on the economic effect of vertical price-fixing.\(^\text{159}\) As in other contexts, purpose occupies a prominent role in the determination of probable effect.\(^\text{160}\) Thus, the question

\(^{156}\) Id. at 1470.


\(^{158}\) See Sylvania, 433 U.S. at 50 n.16 ("Per se rules thus require the Court to make broad generalizations about the social utility of particular commercial practices. The probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against its procompetitive consequences. Cases that do not fit the generalization may arise, but a per se rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them."); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 213 (1940) ("Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions.") (quoting United States v. Trenton Potteries Co., 273 U.S. 392, 397-98 (1927)).

\(^{159}\) See supra text accompanying notes 91-92.

\(^{160}\) In Board of Trade v. United States, 246 U.S. 231 (1918), the Court rejected the government's argument that every agreement affecting price is per se unlawful, observing:
whether *Dr. Miles* should be overruled because it is inconsistent with the market impact test of *Sylvania* should turn on the economic purpose and effect of vertical price-fixing. Freedom to trade is not relevant to determining market impact and thus should not be considered in evaluating *Dr. Miles*.

### III. THE ECONOMIC PURPOSE AND EFFECT OF VERTICAL PRICE-FIXING

The economic justification most commonly advanced in support of vertical restrictions, price and nonprice alike, is the "free rider" problem. A manufacturer may wish to encourage dealers to promote its product and provide services designed to maximize consumer satisfaction. A dealer will hesitate to provide such promotion and services if a competing dealer can avoid the cost of providing them, sell at a lower price and take a "free ride." Personal computers provide an apt example. Most prospective consumers have at best a hazy notion of what a personal computer can do and how it can serve their needs. Educating the consumer may require a substantial investment of time by an articulate well-trained salesperson. A dealer will not long maintain a sales staff.

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. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

*Id.* at 238 (emphasis added).

161. *See* National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 692 (1978) (The Court concluded the rule of reason applies when "competitive effect can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed . . . . [T]he purpose of the analysis is to form a judgment about the competitive significance of the restraint. . . .")

162. *See* Note, *The Resale Price Maintenance Compromise: A Presumption of Illegality*, 38 Vand. L. Rev. 163, 165 (1985) (The continuance of the rule of *Dr. Miles* "res[i]s on the principles of stare decisis and, therefore, do[es] not depend upon political and economic theories that have developed since *Dr. Miles.*") (footnotes omitted). *See supra* notes 152-54 and accompanying text.

163. Professor Telser phrased the problem as follows:

Sales are diverted from the retailers who do provide the special services at the higher price to the retailers who do not provide the special services and offer to sell the product at the lower price. The mechanism is simple. A customer, because of the special services provided by one retailer, is persuaded to buy the product. But he purchases the product from another paying the latter a lower price. In this way the retailers who do not provide the special services get a free ride at the expense of those who have convinced consumers to buy the product.


164. *See* Calvani & Berg, *supra* note 50, at 1182 n.69. *But see* Scherer, *supra* note 29, at 694 (asking how much customer service is necessary to sell light bulbs, clothing, liquor and candy). For other examples of possible free riding, see Calvani & Berg, *supra* note 50, at 1181-82 & n.69 (stereos and furniture).
capable of providing this service if consumers can come to him for information, then walk across the street and buy from another dealer at a lower price made possible by the second dealer's failure to provide similar services.

The manufacturer's interest in preventing free riding through vertical price-fixing is considered legitimate because it is designed not to increase price to the ultimate consumer, but to increase output. If the manufacturer were interested only in increasing price, it could do so by raising its price to the dealers. What it really wants is to increase output without lowering its price to dealers, and it hopes to do this by encouraging the dealers to provide services even though such services will raise the retail price. Essentially, the manufacturer believes that the demand created for its product through the rendition of dealer services will more than offset the decrease in demand resulting from a higher uniform retail price. If this is true, providing dealer services promotes allocative efficiency because it generates greater demand than the corresponding increase in price chokes off. If the manufacturer is wrong, demand for its product will fall rather than rise as consumers switch to competing brands in response to the uniform retail price, and the manufacturer will be forced to reduce the retail price. Loss of sales in a competitive market will force the manufacturer to correct his error.

Thus vertical price-fixing seems to pose little competitive danger. If the manufacturer's judgment is correct, it is efficient and compatible with the goals of competition; if it is incorrect it cannot be sustained so long as there is interbrand competition. Interbrand competition provides the crucial distinction between vertical restraints on the one hand, and horizontal restraints on the others, which have as their purpose the elimination of interbrand competition.

Suppose, however, that the increased volume brought about by increased dealer services coupled with a higher retail price brings no new consumers into the market but simply shifts consumers from other brands. Now, the manufacturer's decision to increase volume through vertical price-fixing and greater dealer services has a twofold impact on interbrand competition. First, it takes sales away from other manufacturers. Second, it causes other manufacturers to respond. Because other manufacturers are selling in the same retail market, they are likely to respond similarly, that is, by imposing resale prices and inducing their dealers to provide additional services. If this reaction spreads throughout the market, consumers will lose the option of educating themselves and purchasing at a lower price as an alternative to purchasing from a dealer who offers educational services coupled with a higher price. Once

165. See Calvani & Berg, supra note 50, at 1182.
167. See Telser, supra note 163, at 89-92.
168. See supra note 22 and accompanying text.
vertical price-fixing becomes standard practice in the industry, inter-
brand competition may not effectively check manufacturer error.169

If vertical price-fixing is not a standard practice in the industry, its
ability to deter free riding is reduced. Much of the information provided
by a dealer handling brand X may be applicable to brand Y, enabling the
latter to take a free ride on educational services provided by the former.
Thus, despite the emphasis free riding has received in the economic liter-
ature and in recent decisions,170 its actual role in vertical price-fixing is
speculative.171 Indeed Telser, who first developed the free rider the-
ory,172 acknowledged that while it provides a rational explanation for
resale price maintenance, its actual significance has not been established
through empirical evidence and is unknown.173 If the free rider theory is
not in fact the explanation, Telser concluded, then the explanation for
manufacturer-induced resale price-fixing must rest in a producers'
cartel.174

A producers' cartel which wishes to establish a uniform price must
confront the problem of cheating.175 All producers may agree that the
uniform wholesale price should be ten dollars per unit, but if a given
producer can profitably sell at nine dollars the temptation to increase
sales by secretly lowering the price may prove irresistible. However, if
the cartel further agrees to fix the retail price at say fourteen dollars per

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169. See Gould & Yamey, Professor Bork on Price Fixing, 76 Yale L.J. 722, 724 (1967)
   (If all or most manufacturers use resale price maintenance, “the competitive sales-in-
   creasing effect would be neutralized; and, other things being equal, total sales would be
   smaller.”); Scherer, supra note 29, at 703 (“When one looks at a single manufacturer
   imposing vertical restraints upon its distributors in a way that maximizes the distributor’s
   profits, then one can infer from the fact that output has increased, that efficiency is likely
to have increased. If, on the other hand, you get a race among numerous rivalrous manu-
facturers to raise margins and increase the level of non-price competition, then the results
are ambiguous. It may well be that efficiency has increased: that the gain to consumers
outweighs the additional cost. But it can go the other way too: the cost of the restraints
can exceed the gain to consumers.”). But see Bork, A Reply to Professors Gould and
Yamey, 76 Yale L.J. 731, 733 (1967) (in order to reap greater profits, some manufacturers
will not require services).

170. See supra note 163 and infra note 171.

171. See, e.g., Baxter, supra note 28, at 747; Fitzgerald, Antitrust, Discounting, and
RPM in the Sporting-Goods Industry: A “Chicago” Reply to Professor Baxter, 14 Anti-
No-Frills Case for a Per Se Rule Against Vertical Price Fixing, 71 Geo. L.J. 1487, 1492-93
(1983); Scherer, supra note 29, at 694-95; Wysocki, Resale Price Maintenance and the
Mass Market: A “Repeat Business” Rebuttal to Professor Baxter, 14 Antitrust L. & Econ.
Rev., No. 3, 91, 99 (1982). But see Sylvania, 433 U.S. at 55 (Court considered free rider
theory in overruling Schwinn’s rule of per se illegality for nonprice vertical restrictions).

172. See Telser, supra note 163.

173. See id. at 104.

174. See id. at 105 (last paragraph).

175. Members of a cartel have an incentive to cheat on the cartel by selling below the
agreed price, thereby increasing sales. See Vogel v. American Soc’y of Appraisers, 744
F.2d 598, 601 (7th Cir. 1984); Easterbrook, The Limits ofAntitrust, 63 Tex. L. Rev. 1, 27
(1984); Comment, Conscious Parallelism and Price Fixing: Defining the Boundary, 52 U.
unit, the incentive to cheat might be removed. Retail prices are known to the public. If a producer wishes to cheat on the cartel price, it still cannot allow its retailers to reduce the retail price from fourteen dollars to thirteen dollars since the lower retail price would soon be detected by other members of the cartel. Lowering the wholesale price would be pointless unless the resulting increase in the dealer's margin will cause dealers to sell more of the price cutting manufacturer's products and thus increase sales volume. According to Telser, the cartel may avoid this possibility by selling through exclusive distributorships: "Thus each distributor becomes an exclusive dealer in one brand and cannot favor one manufacturer at the expense of another." But, even with exclusive dealings, dealers might be induced through greater profit margins to render greater promotional services, and thus increase sales at the expense of other manufacturers.

Clearly, Telser's explanations left some important questions unanswered. He did not try to argue that free riding is in fact an explanation for resale price maintenance, but simply advanced the theory as a plausible explanation. The alternate explanation of retail price maintenance as a device to enforce a producers' cartel left open the possibility that a producer might nonetheless wish to cheat on the cartel because increased dealer services would presumably stimulate demand and thus increase dealer profit margins. This possibility makes vertical price-fixing a feeble instrument for enforcing a producers' cartel.

Nonetheless, Posner adopted Telser's free rider theory as the most persuasive explanation for manufacturer-imposed resale price maintenance. According to Posner, economic analysis suggests two possible reasons for manufacturer-imposed resale price maintenance:

First, the manufacturer may be the cat's paw of cartelizing dealers: the dealers want to fix prices and somehow coerce, or otherwise enlist, the manufacturer (perhaps they pay him) to act as their agent in administering a cartel, which he does either by fixing a uniform retail price for his goods or by assigning nonoverlapping sales territories to the dealers . . . .

Second, the manufacturer may want to increase the amount of non-price competition among the dealers in order to stimulate the provision of point of sale services.

The first reason is a variation of the producers' cartel theory advanced by Telser and the second restates the free rider theory. Conceding that neither theory has "yet been tested empirically" and "it is not en-

176. See Telser, supra note 163, at 97.
179. See supra notes 174-76 and accompanying text.
180. See supra note 163 and accompanying text.
Posner nonetheless concludes that vertical price restrictions "will more commonly be manufacturer imposed and efficiency enhancing than dealer imposed and monopolizing." It follows that such restrictions "[are] consistent with effective competition at the manufacturing level," and should be lawful unless proven to be part of a dealer cartel.

Posner's reasoning is irresistible if we assume vertical price-fixing usually occurs either to enforce a cartel or to prevent free riding. Cartels are themselves per se unlawful under Section 1 and the free rider theory demonstrates that vertical price-fixing may serve procompetitive functions. It should not be banned in all cases simply because it may cloak a cartel, especially because the cartel is unlawful without the aid of a per se rule against vertical price-fixing.

Recently, a third explanation has been suggested as the principal reason for vertical price-fixing. In the "majority of instances," former Assistant Attorney General Baxter has argued, retail price maintenance can be explained by product differentiation. "Any time a manufacturer has successfully created a brand image and an isolated pocket of market power that is associated with that distinctiveness and is able to maintain a wholesale price which is in excess of his marginal cost, he has very strong incentives to induce the retailer to sell more." The existence of market power inherent to product differentiation as a corollary to vertical price-fixing was recognized by Telser. He observed that "a necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product because his product is differentiated in economically relevant respects from competing products." Posner likewise saw a degree of

182. Id. at 165.
183. Id. at 150.
184. Id. at 165.
185. See Regents of the Univ. v. ABC, 747 F.2d 511, 516 (9th Cir. 1984); Jack Walters & Sons v. Morton Bldg., Inc., 737 F.2d 698, 706 (7th Cir. 1984), cert. denied, 105 S. Ct. 432 (1984).
186. See supra notes 163-66 and accompanying text.
187. A fourth justification for vertical price-fixing is the "loss leader" argument, which states that it is unfair to a manufacturer to allow dealers to sell its product at discount prices in order to attract customers into the store, because such prices may lower a product's image and hinder a manufacturer's effort to differentiate its product. See S. Oppenhein, G. Weston & J. McCarthy, Federal Antitrust Laws 541-42 (1977). Although this justification may be valid in some instances, a manufacturer may avoid the problem by simply avoiding multiproduct outlets and by selling to only nondiscount dealers. See Pitofsky, Commentary: In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing, 71 Geo. L.J. 1487, 1494 (1983). In addition, the manufacturer may raise its price in order to discourage dealers from using its product as loss leader. Id.
188. Baxter, supra note 28, at 748.
189. Id.
190. See infra note 196 and accompanying text.
191. Telser, supra note 163, at 87.
market power implied by vertical price-fixing; however, he dismissed it as "negligible." Both overlooked, or at least did not discuss, the possibility that vertical price-fixing could be explained plainly and simply as a way to exercise this limited market power—nothing more, nothing less.

This explanation of vertical price-fixing can be illustrated by drawing on an example used by Baxter. Suppose the competitive wholesale price of a shirt with an alligator on the front is ten dollars. At this price the manufacturer realizes a rate of return comparable to that earned by other manufacturers selling in competitive markets. Economic theory holds that in a competitive market a manufacturer would increase his output until rising marginal cost equals price. Beyond that point selling one more shirt would actually decrease total profit because it could be sold only at a price below the cost of making it. If a manufacturer can sell his entire output at a wholesale price equal to marginal cost he has no incentive to increase sales.

Suppose, however, the shirt with an alligator on the front is uniquely attractive to consumers and the manufacturer has some market power—some power to raise price without an unacceptable loss of sales. He therefore sets a wholesale price of fifteen dollars, five dollars above his marginal cost. Since each additional shirt sold will produce an additional

192. R. Posner, supra note 163, at 150.
193. See Baxter, supra note 28, at 748.
194. The process of competitive pricing has recently been described as follows:

The efficiency consequences of competition may be summarized as follows. When each individual seller in a competitive market takes price as a parameter, each will produce to the point where marginal cost, i.e., the cost to produce the last unit of output, is equal to the price paid by consumers for that unit. At this point, the competitive firm maximizes its profits. Any higher output would drive cost above the market price, while at any lower output the market price would exceed the cost necessary to expand output. When resources are freely mobile between markets, price will in equilibrium be equal to marginal cost in all markets, because higher-return markets will draw resources away from markets offering lower returns, thereby expanding aggregate output in the higher-return market until price is restored to competitive levels.

When the aforementioned conditions are present, allocative efficiency is realized: no reallocation of inputs and outputs would increase aggregate consumer welfare as measured in quantitative terms, because any such reallocation would decrease the value of what consumers as a whole would receive. Moreover, with price equal to average total cost for the representative seller, economic profits, i.e., profits above that which are necessary to maintain investment at current levels, are absent.

195. Id.
196. See NCAA v. Board of Regents, 104 S. Ct. 2948, 2965 n.38 (1984) ("Market power is the ability to raise prices above those that would be charged in a competitive market."); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 27 n.46 (1984) (same); see also Landes & Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937, 937 (1981) ("The term 'market power' refers to the ability of a firm . . . to raise price above the competitive level without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded.").
five dollars of profits, the manufacturer has an incentive to induce his dealers to engage in demand-creating activity. This might be accomplished by establishing a resale price of say thirty dollars, higher than that which would otherwise be set by free-pricing retailers. Retailers benefit because their margin is greater with vertical price-fixing than without it.197 The manufacturer thinks his volume of sales will increase if the retail price is fixed at thirty dollars because dealer services induced by that price will more than offset the loss of sales caused by the artificially high retail price.198

At first glance the economic effect here seems the same as discussed above under the free rider theory.199 A retail price fixed above the level which would prevail in a free retail market induces retailer services which generate more sales than the increased price chokes off. The tradeoff is efficient.

One difference lies in the manufacturer’s primary purpose. Under the free rider theory, the manufacturer’s goals are to induce dealer services and increase sales by preventing free riding.200 Free riding is perceived as an evil which keeps consumers from getting dealer services they value and which restricts output. This fails to distinguish between manufacturers who price at marginal cost and those who price above marginal cost. The free rider argument is persuasive if the manufacturer is pricing at marginal cost and cannot sell its entire output due to free riding. But, where the manufacturer is exercising market power by setting price above the marginal cost, output is restricted by choice. The effect of vertical price-fixing is not to counteract retail inefficiencies but to counteract the normal competitive response to the manufacturer’s own price policy.

Suppose, for example, our shirt manufacturer charged a competitive wholesale price of ten dollars, produced at a level where rising marginal cost equaled that price, but was unable to sell its entire production. Vertical price-fixing imposed to prevent free riding and increasing sales under these circumstances enhances efficiency. It enables the manufacturer to operate at a level of production where the competitive price equals marginal cost, and is thus compatible with the theory of competitive pricing. If one assumes these circumstances usually prevail when vertical price-fixing is used, it is persuasive to conclude, as Posner does,201 that manufacturer-imposed vertical price-fixing will usually enhance efficiency.

If one assumes instead that vertical price-fixing is used to offset reduced demand created by the manufacturer’s decision to price above

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197. While dealers will incur costs in rendering these services, those costs will necessarily be less than the increase in the dealer’s margin with vertical price-fixing. If this were not so, dealers would have little incentive to render services.

198. See supra text accompanying note 167.

199. See supra text accompanying notes 163-67.

200. See supra note 163.

201. See supra notes 178-84 and accompanying text.
marginal cost, then it serves a monopolistic\textsuperscript{202} rather than competitive goal. In a competitive market, price equals marginal cost, whereas in a monopolistic market, price exceeds marginal cost.\textsuperscript{203} Competition is preferred because it leads to lower prices and higher output; monopoly is avoided because it leads to higher prices and lower output.\textsuperscript{204} Producers naturally seek to achieve monopoly power and higher prices. In an ideal monopolist’s world, prices and output would rise simultaneously. In a free market the inescapable penalty for raising the price is reduced sales. Vertical price-fixing provides a way to avoid this penalty by replacing free pricing at the retail level with contract pricing, and, in effect, sharing monopoly profits with retailers.

Telser and Posner assumed market power created by product differentiation invariably accompanies vertical price-fixing.\textsuperscript{205} Baxter persuasively argued that exercise of this market power is the principal explanation for vertical price-fixing.\textsuperscript{206} If so, vertical price-fixing simply facilitates monopoly profit\textsuperscript{207} maximization through the projection of power from one market to another by contract. If our shirt manufacturer had an absolute monopoly in the shirt market, most would agree that vertical price-fixing or other vertical restrictions designed to project that monopoly power from the manufacturing to the retail level should be unlawful. Under such circumstances there would be no interbrand competition justifying a restriction on intrabrand competition.\textsuperscript{208} But our manufacturer only has a monopoly on shirts with an alligator on the front. At some price, this monopoly power is exhausted because consumers will decide to purchase shirts without alligators for, say, twenty dollars rather than shirts with alligators for thirty. Should antitrust law

\textsuperscript{202} The goal is monopolistic because vertical price-fixing is used to help maintain a price higher than marginal cost, a characteristic of monopoly. See infra note 203.

\textsuperscript{203} See Gellhorn, An Introduction to Antitrust Economics, 1975 Duke L.J. 1, 33 (“In [a] monopoly . . . the profit-maximizing firm equates marginal cost to marginal revenue and marginal revenue does not equal price (price is greater).”) (emphasis in original). See infra note 212.

\textsuperscript{204} See infra note 212.

\textsuperscript{205} See supra notes 191-92 and accompanying text.

\textsuperscript{206} See Baxter, supra note 28, at 748. If a manufacturer is selling his entire output at a price equal to his marginal cost, additional sales will drive marginal cost above price and reduce profits. Thus vertical price-fixing will normally be attractive to a manufacturer who either is selling at a price above marginal cost, or cannot sell his entire output at a price equal to marginal cost. Baxter’s view that the former rather than the latter is the principal explanation seems persuasive, because vertical price-fixing is generally favored by well established firms with recognized products and some market power rather than by fledgling firms seeking to gain or retain a foothold in the market. See infra note 210.

\textsuperscript{207} Monopoly profit is used here to mean profit resulting from a price in excess of marginal cost, in contrast to competitive profit which would be produced by a price equal to marginal cost. See supra note 203.

be concerned about limited market power derived from product differentiation? Baxter says no,

not because it is clearly the right answer in any economic sense, but because I have a strong bias in favor of letting people do whatever they want, at least in the absence of a demonstration that they are imposing harm on someone else, I see no reason whatsoever that a company should not be permitted to have a go at marketing $30 shirts with alligators on them.209

Clearly, in a free market a firm should be permitted to try to sell its product at any price it chooses. The only constraint on unilateral pricing is economic, not legal.210 But that is not the question. Dr. Miles does not interfere with the manufacturer’s right to preserve or create product differentiation by unilaterally setting a wholesale price at a level which produces a thirty dollar retail price. If, however, he chooses to price the product above his marginal cost, should the manufacturer be allowed to avoid the usual competitive consequence of reduced output by joining together with retailers to establish a uniform retail price?

When viewed in this way it seems apparent that vertical price-fixing impedes the operation of competitive markets by making it easier to maintain prices above marginal cost. While the economic effects of horizontal dealer price-fixing are distinguishable, the difference is one of degree, not kind. This was implicitly recognized in the Antitrust Division’s amicus brief in Monsanto urging that Dr. Miles be overruled:

While it is theoretically possible that a group of distributors might fix a price at the same level that a manufacturer would choose to have his goods resold, this is highly unlikely. The manufacturer would attempt to choose a resale price level that would stimulate demand-enhancing promotional or service activities by its dealers and thus would increase output; his interest in maximizing profits and society’s interest in enhancing output (and promoting interbrand competition) generally will coincide. By contrast, if the dealer cartel were to set the price, it would find that a still higher price, causing a reduction in demand from that which would result from the manufacturer’s preferred price, would yield greater profits to the cartel members; the cartel would attempt to maximize its profits at the expense of restricting overall output of the product below the socially optimal level. Thus, horizontal dealer price-fixing poses great dangers not present in resale price maintenance by a manufacturer and therefore is properly subject to per se prohibition.211

210. Ideally, the economic penalty for pricing above the market would be an immediate decline in sales to zero. A farmer who offers his grain at a price above market normally incurs this penalty. Few other sellers do. Pricing in most industries involves the exercise of market power, i.e., the ability to choose from a range of prices with no danger that sales will fall to zero even if the price selected is above that which would prevail in a perfectly competitive market.
Under the Antitrust Division's argument, because both vertical and horizontal price-fixing produce a higher price, the crucial question is whether both will usually reduce output below "the socially optimal level." Horizontal price-fixing obviously does because it is monopolistic in nature and under monopoly conditions profit maximization dictates higher prices and lower output than would prevail in a competitive market.212 If, as seems likely, vertical price-fixing is generally used to maximize manufacturing profits while holding price above marginal cost, it similarly results in higher prices and lower output. This is because the proper comparison is between the level of output with a manufacturer's price above marginal cost and the level of output with a manufacturer's price equal to marginal cost. Clearly, the latter maximizes output because no rational producer will raise output beyond the level at which rising marginal cost equals price.213 Since both forms of price-fixing

212. The firm with monopoly power is thus able—unlike the competitive firm—to affect unilaterally the price at which it sells. This is the essential distinguishing characteristic between a competitive firm and a firm with monopoly power. Whereas the purely competitive firm must take price as a parameter, and therefore will expand output to the point where marginal cost is equal to the market price, a firm with monopoly power faces a downward-sloping demand curve for its product, i.e., it can expand sales only by lowering its price. Assuming that the firm with monopoly power cannot discriminate in price between purchasers, the marginal revenue obtained from an additional sale will be less than the price paid by the marginal purchaser because in order to make that additional sale, the monopoly firm also must reduce its price to all customers, including those that would have purchased even without the reduction in price. Thus, unlike the competitive firm, for whom price equals marginal cost, price exceeds marginal cost for the firm with monopoly power.

Because the short-run, profit-maximizing firm with monopoly power will continue to raise its price until any further increase would be offset by a proportionately greater reduction in the quantity purchased, the monopolistic profit-maximizing price will be at a level of output lower than that which would prevail under competitive conditions. This circumstance is responsible for a principal economic objection to monopoly. Because the monopolist's product is priced higher than the competitive price, consumers may be induced to substitute products that are priced lower than the monopolist's product, even though those alternative products actually cost more to produce. This so-called "dead weight" loss of monopoly pricing can best be illustrated by an example. Assuming that a monopolist's product costs $5.00 to produce (recognizing that cost in economic terms includes a normal return on equity capital), and is priced by the profit-maximizing monopolist at $5.25, a consumer may be induced by the higher price to purchase a substitute product that is priced at $5.15. If the substitute product is priced under competitive conditions, its price is equal to its cost of production. Accordingly, by selecting the substitute product, the consumer actually satisfies his wants by purchasing a commodity that requires more of society's scarce resources to produce, even though its price is below that fixed by the short-run, profit-maximizing monopolist. In this way, monopoly induces consumers to substitute more costly products for less costly ones.

Johnson & Ferrill, supra note 194, at 592 (emphasis in original) (footnotes omitted).

213. As is pointed out above, see supra note 189 and accompanying text, this assumes the manufacturer could sell his entire output at a price equal to marginal cost. If that is not the case, that is, if the manufacturer is pricing the product at marginal cost but still cannot sell its entire output and vertical price-fixing is used to stimulate demand, then, and only then, will vertical price-fixing be compatible with competition. This rare case does not justify abandoning Dr. Miles. It may justify an exception to the per se rule
present great danger of higher prices and lower output, both are properly subject to per se prohibition\(^{214}\) without "elaborate inquiry as to the precise harm they have caused or the business excuse for their use."\(^{215}\)

To argue that vertical price-fixing enhances output ignores the fact that output is first reduced by maintaining a price above marginal cost and vertical price-fixing is then used to counteract the reduction. The Antitrust Division's argument is persuasive only if one accepts pricing above marginal cost as a neutral event. Such pricing is an exercise of market power and should not be viewed neutrally.\(^{216}\)

where the manufacturer can prove its selling price equals or approaches marginal cost. As in the predatory pricing area, average variable cost could serve as a proxy for marginal cost, since marginal cost is not susceptible to proof. See *Superturf, Inc. v. Monsanto Co.*, 660 F.2d 1275, 1281 (8th Cir. 1981); O. Hommel Co. v. Ferro Corp., 659 F.2d 340, 347 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982); Areeda & Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 716 (1975). The net result would be that the free rider theory would justify vertical price-fixing only where competitive wholesale pricing fails to generate sales sufficient to operate at the optimal level. Its primary purpose then would be demand enhancement rather than monopoly profit maximization.

214. Since nonprice vertical restraints do not directly interfere with free pricing, the principal method of competing in a free market, it is appropriate to assume they are usually employed for the purpose of strengthening the dealer network by enabling it to focus on interbrand competition. Where nonprice restraints are shown to serve monopolistic pricing practices at the producer level, they should be held unlawful under the rule of reason. While vertical price-fixing may similarly enable dealers to focus on interbrand competition, it is a clumsy tool for this purpose since it denies dealers needed price flexibility in an intensely competitive market. Furthermore, the generally recognized fact that vertical price-fixing (but not other vertical restraints) can be used only by a manufacturer with some market power, see text accompanying *supra* note 36, suggests it is usually used to facilitate exercise of that power. The critical distinction between price and nonprice restraints is that while price restraints will usually reduce output by facilitating manufacturer pricing above marginal cost, nonprice restraints will not, or at least will not usually be intended to do so.

215. *Northwest Wholesale Stationers, Inc. v. Pacific Stationer & Printing Co.*, 105 S. Ct. 2613, 2617 (1985) (quoting *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958)); *see Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 343-44 (1982) ("The costs of judging business practices under the rule of reason . . . have been reduced by the recognition of per se rules. . . . For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a fullblown inquiry might have proved to be reasonable.") (footnotes omitted). *But see Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 n.16 (1977) ("Once established, *per se* rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule-of-reason trials, . . . but those advantages are not sufficient in themselves to justify the creation of *per se* rules. If it were otherwise, all of antitrust law would be reduced to *per se* rules, thus introducing an unintended and undesirable rigidity in the law.").

216. This is not to say unilateral pricing designed to enhance product differentiation is an unmitigated evil, but merely that it is incompatible with free market theory and therefore anticompetitive. Congress did not ban all anticompetitive behavior, and this is one type of anticompetitive conduct which, because of its unilateral nature, falls into a "gap" in the Sherman Act's proscription against unreasonable restraints of trade, so long as it does not involve threatened monopolization. See *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984). Congress did, however, ban concerted action undertaken with the purpose and effect of increasing price and reducing output. Properly viewed, vertical price-fixing is just such conduct.
The notion that vertical price-fixing enables producers to maximize monopoly profits rather than increase output draws support from the Court's recent decision in Jefferson Parish Hospital District No. 2 v. Hyde. Discussing the legality of tying arrangements, the Court observed that tying contracts may be used by sellers with some market power to discriminate in price among various purchasers. For example, the manufacturer of a copying machine may charge a low price for the machine on condition that all paper used in the machine be purchased from the manufacturer. The price charged for the machine may be less than high intensity users would pay without the tie, but the manufacturer will recoup this lost profit by selling them a large quantity of paper. Low intensity users are drawn into the market by the low price for the machine. The net effect is that more machines are sold with the tie than without because the price of the package varies with the intensity of use. Should increased output achieved through tying paper to copying machines be viewed as procompetitive or as a device for maximizing monopoly profits? The Court answered:

[T]he law draws a distinction between the exploitation of market power by merely enhancing the price of the tying product, on the one hand, and by attempting to impose restraints on competition in the market for a tied product, on the other . . . [A tying arrangement] . . . can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie . . .

Just as a tying contract which increases output above the level which would prevail with a single monopolistic price provides no justification for a tie, similarly vertical price-fixing which increases output above the level which would prevail with a monopolistic price set by the supplier provides no justification for vertical price-fixing. Only if the manufacturer's price equals marginal cost should increased output be viewed as procompetitive.

CONCLUSION

The emphasis in antitrust law on practical economic effects flatly con-
tradicts the formalistic reasoning of Colgate. Furthermore, Colgate is rooted in the freedom to trade concept and therefore represents a view of antitrust law the present Court has not embraced. There is no sound reason for the Court to be concerned about the erosion of Colgate. Unfortunately, just as earlier Courts used artificial distinctions to narrow Colgate and expand the per se rule of Dr. Miles, this Court may be willing to breathe new life into the formalistic reasoning of Colgate to contract the scope of Dr. Miles. Antitrust jurisprudence would be advanced if the Court recognized Colgate as an exercise in formalism and overruled it. If, as the Court seems to fear, Dr. Miles would be unacceptable without the restraining force of Colgate, it too should be overruled. It appears, however, that while the economic justification for Dr. Miles may have been overstated in the past, it is well founded. Properly analyzed, vertical price-fixing leads to higher prices and lower output just as horizontal price-fixing does. So long as a category of per se antitrust violations exists, that is where vertical price-fixing belongs.