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The Sad Legacy of *GTE SYLVANIA*  
and its 'Rule of Reason': The  
Dealer Termination Cases and the  
Demise of § 1 of the Sherman Act

*Mark E. Roszkowski*

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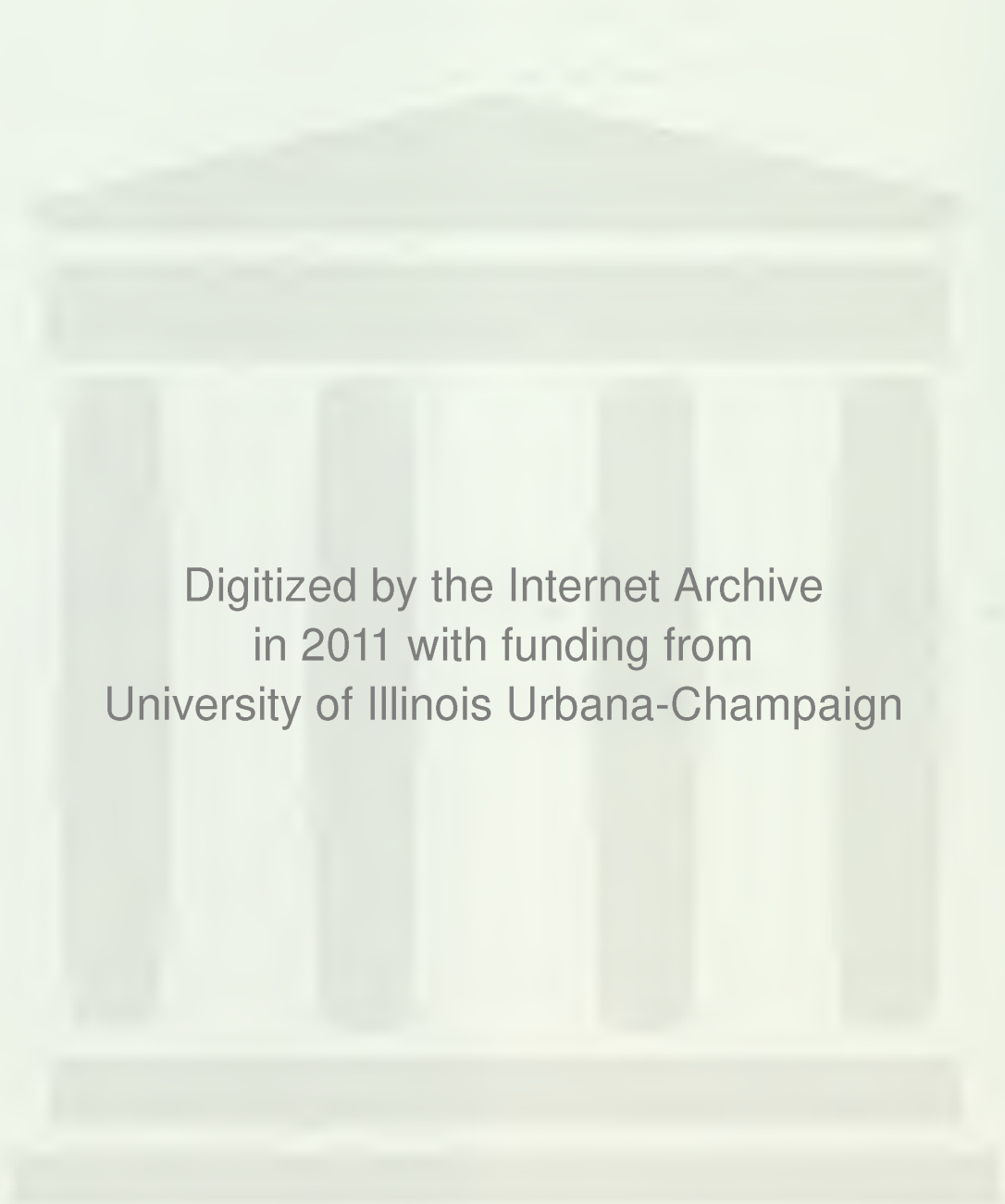
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April 1989

The Sad Legacy of GTE SYLVANIA and its 'Rule of Reason':  
The dealer Termination Cases and the Demise of 1 of the Sherman Act

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THE SAD LEGACY OF GTE SYLVANIA AND ITS "RULE OF REASON":  
THE DEALER TERMINATION CASES AND THE DEMISE  
OF § 1 OF THE SHERMAN ACT

ABSTRACT

Since the Supreme Court's decision in Continental T.V., Inc. v. GTE Sylvania, Incorporated (1977), a "rule of reason" standard has been applied to judge the legality under § 1 of the Sherman Act of nonprice vertical restraints, also known as vertical market division (territorial, customer, or location restrictions imposed upon wholesalers or retailers in the distribution of a manufacturer's product). This approach differs from the rule of "per se" illegality that long has governed vertical price restraints (vertical price fixing, or resale price maintenance). This article examines GTE Sylvania, its rationale, its application, and its effect upon antitrust enforcement under § 1 of the Sherman Act, particularly cases involving termination by a common supplier of a price-cutting retail or wholesale dealer at the request of a competing dealer. The article concludes that GTE Sylvania should be overruled to impose a rule of "per se" illegality for all vertical restraints of trade, price and nonprice.



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## I. Introduction

Section 1 of the Sherman Act, the foundation of United States antitrust law for almost a century, provides in relevant part that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."<sup>1</sup> As the primary tool of antitrust enforcement, § 1's basic proscription is backed by a battery of criminal<sup>2</sup> and civil sanctions including private actions for treble damages available to "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws."<sup>3</sup>

Restraints of trade governed by the Sherman Act are traditionally classified as horizontal or vertical. The term "horizontal" restraint generally refers to loose knit agreements or combinations among competitors (that is, persons at the same functional level) to achieve a wide variety of anticompetitive results such as price fixing, division of markets by territories or otherwise, and coercive elimination of competitors by concerted conduct. The term "vertical" restraint refers to an agreement or combination among persons standing in a buyer-seller or supplier-supplied relationship; that is, among persons at different functional levels. Vertical restraints, unlike horizontal restraints, often are imposed as part of express contract (such as a franchise agreement) between the parties, and usually are characterized as either "price" or "nonprice." The result of a vertical price restraint (known also as "vertical price fixing," "resale price maintenance," or "RPM") is to control or otherwise affect the price at

which the buyer (usually a wholesaler or retailer) resells the goods. For example, a manufacturer of loudspeakers might sell its products to a retailer only on condition that the retailer resell the speakers to its customers only at prices set by the manufacturer. In contrast, vertical nonprice restraints (known also as "vertical market division") generally limit the territories within which a distributor or retailer may resell the manufacturer's product (a "territorial" restriction), the place or places of business from which the buyer may resell (a "location" restriction), or the types of customers to whom the buyer may resell (a "customer" restriction).<sup>4</sup> All vertical restraints, price or nonprice, are designed to restrict or eliminate intrabrand competition; competition among dealers in a manufacturer's product for the same customers.

In judging the legality of both horizontal and vertical restraints under § 1, the basic standard is the "rule of reason" announced in Standard Oil Company of New Jersey v. United States (1911).<sup>5</sup> Under the rule of reason standard, the Sherman Act does not condemn all trade restraints, which would include those imposed by ordinary contracts. Rather, § 1 condemns only those restraints that unreasonably restrain competition. In applying this rule of reason, the court must undertake an often lengthy and detailed analysis of: (1) the harm to competition resulting from the challenged restraint; (2) whether the restraint achieves any countervailing legitimate and significant procompetitive objectives; and (3) whether the legitimate objectives of the restraint can be achieved by alternative methods less restrictive of competition.<sup>6</sup>

Although reasonableness is the basic standard by which all § 1 violations are judged, courts use two approaches to determine reasonableness. In most cases, the court, in applying the three-part rule of reason standard, permits the defendant to introduce evidence of the reasonableness of the restraint to avoid a violation. The Supreme Court has, however, declared that certain specific practices or business relationships are so inherently destructive of competition that they are unreasonable per se; that is, "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."<sup>7</sup> The defendant is not permitted to justify conduct in the per se category because the Court has already determined, through considerable experience with the practice or device, that it has no purpose other than to destroy or stifle competition. Per se rules simplify enforcement of the Act, and reduce the length of litigation because the plaintiff is not required to refute the defendant's justification. Per se rules also provide greater predictability and therefore greater deterrence against conduct the law finds particularly offensive. Per se illegality has been imposed, on a case by case basis, on a variety of horizontal conduct, such as price fixing.<sup>8</sup> Similarly, vertical price fixing (resale price maintenance) has been per se illegal under § 1 since the Supreme Court's classic 1911 decision, Dr. Miles Medical Company v. John D. Park & Sons Co.<sup>9</sup> In contrast, since the Supreme Court's decision in Continental T.V., Inc. v. GTE Sylvania Incorporated (1977) (hereinafter GTE Sylvania),<sup>10</sup> the legality under § 1 of nonprice vertical restraints imposed upon dealers in the distribution of a

manufacturer's product is to be judged under a rule of reason rather than "per se" analysis.

This paper examines GTE Sylvania, its rationale, its application, and the effect the decision has had on antitrust enforcement under § 1, particularly the law governing termination by a common supplier of a price cutting retail or wholesale dealer at the request of another dealer. Though apparently unrelated to the issue addressed in GTE Sylvania (whether a location restriction in a franchise agreement should be governed by per se or rule of reason analysis), GTE Sylvania is the basis of the two recent decisions outlining the current Supreme Court approach to price related dealer terminations: Monsanto Company v. Spray-Rite Service Corporation (1984)<sup>11</sup> and Business Electronics Corporation v. Sharp Electronics Corporation (1988).<sup>12</sup>

Monsanto significantly increased the plaintiff's burden of proof in price related dealer termination cases by holding that an illegal price-fixing conspiracy may not be inferred merely from the existence of competing dealers' complaints about price cutting or even from the fact that plaintiff's termination came about in response to such complaints. Rather, the plaintiff must adduce evidence "that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."<sup>13</sup> In Business Electronics, a case, like Monsanto, involving termination by a supplier of a price cutting dealer at the request of another dealer, the court held that an agreement between a manufacturer and a dealer to terminate a second dealer is a per se § 1 Sherman Act violation only if the surviving dealer expressly or impliedly agrees to set its prices at some level.<sup>14</sup>



Collectively, these decisions and the lower court decisions applying them clearly indicate the bankruptcy of GTE Sylvania and its rule of reason standard. GTE Sylvania is responsible for a dealer termination law that: is based upon a narrow and erroneous assumption regarding the basic purpose of antitrust law; glorifies but confuses the essentially artificial distinction between price and nonprice vertical restraints; and erroneously characterizes blatantly horizontal conduct as vertical. GTE Sylvania has further created a business climate: in which virtually any restraint of trade that arguably can be characterized as "vertical," except the barest and most blatant forms of resale price maintenance, is per se legal; in which a group of independent dealers in a manufacturer's product can with impunity conspire to divide the markets and fix the prices for those products; and in which dealers who refuse to go along with these effectively horizontal intrabrand conspiracies may be terminated by the manufacturer, who may act openly and with virtual immunity from antitrust scrutiny or liability. In sum, current dealer termination law, grounded upon GTE Sylvania's rule of reason, is a toothless legal standard, providing a blank check for coercion and exclusionary behavior by powerful dealers openly policed by manufacturers, which is structurally designed to make it difficult if not impossible for injured private plaintiffs to recover.

Part II of this paper analyzes the evolution of the legal standard governing nonprice vertical restraints, and the purported procompetitive justifications for such restraints. Parts III and IV indicate how the rule of reason is applied under GTE Sylvania, and contrasts

its approach to the results dictated by a more traditional, and discriminating, application of the rule of reason. Parts V and VI analyze the debilitating effect that GTE Sylvania's rule of reason has had upon the law governing price related dealer terminations, and, more generally, upon all antitrust enforcement under § 1 of the Sherman Act. This paper concludes that the current judicial approach to vertical nonprice restraints must be dramatically changed. Rather than eliminating or further diluting the long-standing per se rule against vertical price restraints, as some have suggested<sup>15</sup> to comport with GTE Sylvania, GTE Sylvania itself should be overruled to restore a rule of "per se" illegality for all vertical restraints of trade, price and nonprice. Further, the liberal evidentiary standards regarding proof of conspiracy traditionally applicable to § 1 Sherman Act violations also should be applied in dealer termination cases.

## II. The Legal Standard Governing Nonprice Vertical Restraints

### A. Evolution of the Current Judicial Approach

The legal principles governing nonprice vertical restraints are of fairly recent vintage, being primarily derived from three Supreme Court cases: White Motor Company v. United States (1963),<sup>16</sup> United States v. Arnold, Schwinn & Co. (1967),<sup>17</sup> and Continental T.V., Inc. v. GTE Sylvania, Incorporated (1977).<sup>18</sup> Take careful note of the judicial approach in Schwinn because rejecting the so-called "Schwinn doctrine" is the basis of the court's holding in GTE Sylvania.

In White Motor, White Motor Company, a manufacturer of trucks and parts, sold its products to distributors, dealers, and directly to

certain various large users. The government challenged White's imposition of both territorial and customer restrictions on its distributors and dealers alike. Under the territorial clause, the buyer was granted the exclusive right to sell in a described territory. Each buyer also agreed to sell only to "individuals, firms, or corporations having a place of business and/or purchasing headquarters in said territory." Dealers and distributors also agreed not to sell to the federal or any state government or departments or political subdivisions thereof, because White planned to serve these lucrative accounts itself. Thus, by vertical restriction White effected a territorial division of markets among its wholesalers and distributors, who were effectively precluded from raiding each other's territories by the customer location requirement. Clearly such an arrangement would be "per se" illegal if the result of horizontal combination between the distributors or dealers.<sup>19</sup> Further, White insulated itself from competition from its buyers for the fleet accounts. The trial court declared the restrictions illegal "per se," refusing to hear evidence in justification, and granted summary judgment for the government. The Supreme Court reversed and remanded the case for trial, noting that "this is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us."<sup>20</sup> Thus, White Motor did not articulate the standard applicable to territorial and customer restrictions. It did not declare them "per se" illegal nor did it say a rule of

reason standard governs. The court simply stated that it did not know enough about the competitive impact of the restraints to assign them to one rule or the other. It therefore remanded the case for trial.

Justice Clark, in a dissenting opinion joined by Chief Justice Warren and Justice Black, strongly disagreed with the majority noting that

I believe that these "bare bones" really lay bare one of the most brazen violations of the Sherman Act that I have experienced in a quarter of a century.<sup>21</sup>

Justice Clark argued that White Motor justified its contracts as the only feasible way to compete effectively with bigger and more powerful competitors, a "business necessity" argument long rejected in anti-trust cases.<sup>22</sup> Further, the agreements completely eliminated competition among White dealers and should not be permitted simply because they are vertical:

White does not contend that its distribution system has any less tendency to restrain competition among its distributors and dealers than a horizontal agreement among such distributors and dealers themselves. It seems to place some halo around its agreements because they are vertical. But the intended and actual effect is the same as, if not even more destructive than, a price-fixing agreement or any of its per se counterparts. This is true because price-fixing agreements, being more easily breached, must be continually policed by those forming the combination, while contracts for a division of territory, being easily detected, are practically self-enforcing. . . .

The Court says that perhaps the reasonableness or the effect of such arrangements might be subject to inquiry. But the rule of reason is inapplicable to agreements made solely for the purpose of eliminating competition. . . . The same rule applies to the contracts here. The offered justification

must fail because it involves a contention contrary to the public policy of the Sherman Act, which is that the suppression of competition is in and of itself a public injury. To admit, as does the petitioner, that competition is eliminated under its contracts is, under our cases, to admit a violation of the Sherman Act. No justification, no matter how beneficial, can save it from that interdiction.<sup>23</sup>

The White Motor case subsequently was settled by consent decree under which the manufacturer abandoned its distribution scheme. Accordingly, the case left considerable doubt concerning the proper standard to be applied to nonprice vertical distribution restraints. This doubt was temporarily removed four years later in Schwinn. In this case, the government attacked Schwinn's complex and restrictive bicycle distribution plan. The plan, adopted in 1952, was designed to "promote sales, increase stability of its dealer and distributor outlets, and augment profits." Although Schwinn's share of the bicycle market fell between 1951 and 1961 from 22.5% to 12.8%, its dollar amount sales rose substantially. The particulars of the challenged system were as follows. Initially, Schwinn reduced the number of retail outlets from 15,000 to 5,500, and instituted a practice of franchising approved retail dealers. Schwinn distributors and retailers were not required to handle only Schwinn bicycles. They could and ordinarily did carry a variety of brands. Schwinn distributed its bicycles in three ways: (1) direct sales to wholesale distributors, (2) sales to retailers through consignment or agency arrangements with distributors, and (3) sales to retailers under the so-called "Schwinn plan," involving direct shipment by Schwinn to the retailer with Schwinn billing the dealer, extending credit, and paying

a commission to the distributor taking the order. Under this plan the distributor acted essentially as a manufacturer's representative or sales agent, forwarding retailer's orders to the factory. Under this plan, the distributor never had title to or possession of the bicycles. Approximately 75 percent of all Schwinn sales were made under the "Schwinn plan."

In this context, Schwinn imposed a number of restrictions challenged by the government. The number of retail dealers was limited and retailers were franchised only as to a designated location or locations. Each dealer was authorized to purchase only from or through the distributor authorized to serve that area. Further, retailers were allowed to sell only to consumers, not to an unfranchised dealer, such a discount department store. That is, dealers were not allowed to act as wholesalers. To supply these retailers, Schwinn assigned specific exclusive territories to each of its 22 distributors, who were authorized to sell only to franchised Schwinn dealers in their respective territories. The myriad territorial, customer, and location restraints in this case effectively insulated both Schwinn distributors and dealers from intrabrand competition at either functional level. That is, Schwinn, by vertical action, had effected a territorial market division among both its wholesalers and retailers. Clearly, a horizontal agreement accomplishing this result would be "per se" illegal.

The court however refused to characterize the arrangement as a dealer or wholesaler cartel, but instead viewed it as wholly vertical

and adopted the following standard, later designated the "Schwinn doctrine," to test the legality of vertical nonprice restraints:

[T]he proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer parts with title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss.

As the District Court held, where a manufacturer sells products to his distributor subject to territorial restrictions upon resale, a per se violation of the Sherman Act results. And, as we have held, the same principle applies to restrictions of outlets with which the distributors may deal and to restraints upon retailers to whom the goods are sold. Under the Sherman Act, it is unreasonable to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. . . . Such restraints are so obviously destructive of competition that their mere existence is enough. If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale. . . . On the other hand, as indicated in White Motor, we are not prepared to introduce the inflexibility which a per se rule might bring if it were applied to prohibit all vertical restrictions of territory and all franchising, in the sense of designating specified distributors and retailers as the chosen instruments through which the manufacturer, retaining ownership of the goods, will distribute them to the public. Such a rule might severely hamper smaller enterprises resorting to reasonable methods of meeting the competition of giants and of merchandising through independent dealers, and it might sharply accelerate the trend towards vertical integration of the distribution process. But to allow this freedom where the manufacturer has parted with dominion over the goods--the usual marketing situation--would violate the ancient rule against restraints on alienation and open the door to exclusivity of outlets and limitation of territory further than prudence permits.<sup>24</sup>

Thus, in Schwinn the court held that vertical nonprice restrictions imposed in conjunction with the sale of goods were "per se" illegal

but that the same restrictions if used in an agency or consignment arrangement (such as the "Schwinn plan") were governed by a rule of reason approach. Applying this standard to the facts, the court validated the restrictions on bicycles sold under the "Schwinn plan" finding that the restrictions were reasonably necessary to meet the competitive problems posed by mass merchandisers such as Sears, Roebuck or Montgomery-Ward, thus satisfying the rule of reason. With respect to the portion of Schwinn's sales for which the distributors acted as ordinary wholesalers, buying and reselling Schwinn bicycles, the court held that the challenged territorial and customer restrictions were "per se" illegal.

The holding in Schwinn was harshly criticized for making the legality of vertical nonprice restraints turn upon whether a sale or nonsale transaction is involved, a distinction viewed by many as artificial and formalistic, bearing no relationship to competitive effect.<sup>25</sup> It also is arguably inconsistent with the court's previous refusal in Simpson v. Union Oil (1964)<sup>26</sup> to allow consignment as a means to impose resale price maintenance (vertical price restrictions). Supporters of Schwinn, however, assert that it recognizes a legitimate distinction: the degree of vertical integration. Assuming a legitimate consignment arrangement involving significant integration, rather than the sham outlined in Simpson, a consigner assumes risks not undertaken by an outright seller, such as risk of loss, insurance, taxes, and credit. Thus, when the retailer or wholesaler acts merely as an agent or representative of the manufacturer, it is arguable that the seller should be able to exert more control over the



disposition of the goods than in cases when the wholesaler or retailer purchases and assumes the attendant risks.<sup>27</sup>

Whether the "Schwinn doctrine" recognizes a legitimate distinction, however, is now moot because Schwinn was explicitly overruled in 1977 in GTE Sylvania. In this case, Sylvania, a manufacturer of television sets, sold directly to franchised retail dealers. The franchise agreement contained a location clause, allowing the franchisee to sell only from a designated location or locations. The agreement did not grant territorial exclusivity to franchisees (that is, Sylvania was free to license new dealers in competition with an existing franchisee), but did not preclude them from selling competing brands. The case arose when Sylvania franchised Young Brothers, an established San Francisco television retailer, as an additional retail outlet one mile from Continental T.V., one of Sylvania's most successful franchised dealers. In displeasure over Sylvania's decision, Continental cancelled a large order, and indicated an intent to begin selling Sylvania televisions in Sacramento, in violation of the location restriction. Upon termination of the franchise, Continental sued Sylvania challenging the legality of Sylvania's location clause under § 1 of the Sherman Act. The district court, relying upon Schwinn, instructed the jury that by seeking to restrict the locations from which Continental could sell Sylvania products, Sylvania had committed a per se violation of § 1 of the Sherman Act. The jury found that the location restriction violated § 1 and the Court of Appeals reversed,<sup>28</sup> distinguishing Schwinn and holding that because Sylvania's location clause had less potential for competitive harm

than the restrictions proscribed in Schwinn, they should be judged under a rule of reason rather than "per se" standard. The Supreme Court granted certiorari to reexamine the legal standard applicable to nonprice vertical restraints. Note that because title to the televisions had passed to Continental, strict application of Schwinn would have required a finding that the challenged restriction was "per se" illegal.

After reviewing Schwinn, the Court noted that:

The market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition. . . .

Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. . . . For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product. Because of market imperfections such as the so-called "free rider" effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.<sup>29</sup>

The Court therefore concluded that:

[T]he distinction drawn in Schwinn between sale and nonsale transactions is not sufficient to justify the application of a per se rule in one situation and a rule of reason in the other.

. . . [Vertical] restrictions, in varying forms, are widely used in our free market economy. As indicated above, there is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary. Certainly, there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a "pernicious effect on competition" or that they "lack . . . any redeeming virtue." Accordingly, we conclude that the per se rule stated in Schwinn must be overruled. In so holding we do not foreclose the possibility that particular application of vertical restrictions might justify per se prohibition . . . But we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than--as in Schwinn--upon formalistic line drawing.

In sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to Schwinn. When anti-competitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under § 1 of the Act.<sup>30</sup>

In short, vertical nonprice restraints, unlike vertical price restraints (resale price maintenance) are now governed by a rule of reason rather than "per se" standard. Whether such preferred treatment is justified is questionable. By definition, vertical restraints, price and nonprice, reduce or eliminate intrabrand competition. That is, all vertical restraints restrict in some manner the ability of the buyers to compete among themselves for the trade in the manufacturer's product. Any argument made in favor of nonprice vertical restrictions also can be used to justify resale price maintenance, long a per se Sherman Act violation. Further, although

vertical nonprice restrictions do not fix resale prices, they always eliminate or significantly reduce competition, including price competition, among dealers governed by the restrictions. That is, by insulating (territorially or by customers) dealers who might otherwise compete in the sale of a product, vertical nonprice restrictions may indirectly achieve resale price maintenance. In addition, because vertical nonprice restraints obviously restrict intrabrand competition, sound antitrust policy requires that any argument against treating territorial, customer, or location restrictions as per se violations must be based on some offsetting benefit to competition.<sup>31</sup> As noted by the Court in GTE Sylvania, this offsetting benefit is enhanced interbrand competition--the ability of manufacturers who use the restrictions in distributing their products to compete more effectively against other manufacturers. The following material examines the purported interbrand benefits of nonprice vertical restraints.

## B. Purported Justifications for Nonprice Vertical Restraints

### 1. Economies of Scale

One argument supporting manufacturer imposed territorial restraints is that without them, some competing dealers would raid other dealers' territories, depriving them of the minimum volume necessary to operate efficiently. Commentators have identified at least three flaws in this argument. First, its premise of an administered economy is fundamentally at odds with the concept of competition envisaged by the Sherman Act. That is, the economies of scale argument assumes the

manufacturer, rather than the numerous competing retailers, should decide the character of competition at the retail level. As noted by Professor Sullivan:

Competition calls not for peace and order, but for vigor and danger to be the rule of trade. It envisages decisions about price, scale and other important matters being made by numerous competing traders, some of whom will judge right and some of whom will judge wrong. It does not call for a monolithic, untested judgment about the appropriate scale for retail operations made by the manufacturer acting as a "manager" of all the units in the economy handling his product, but for a public judgment proved in the marketplace, where the dealer bets his capital that he knows what he is doing and the consumer votes with his purchasing power to tell the dealer whether he is right or wrong.<sup>32</sup>

In addition, the economy of scale argument breaks down factually in virtually every case. For example, in the most common case in which a dealer carries products of a number of manufacturers, a dealer's minimum efficient scale is not likely to be fixed by reference to the scope of territorial protection offered by one manufacturer.<sup>33</sup> In addition,

[A] manufacturer making territorial assignments has yet to present evidence that it studied retail operations in order to determine the most efficient scale, or even developed by intuition norms about scale which it consistently applied. Thus the supposed theoretical merits of the "economies of scale" argument as a justification for territorial resale restrictions never seem to be manifested in the marketplace.<sup>34</sup>

## 2. Necessary Promotion, Facilities or Services--Free Riders

Proponents of vertical market division also assert that dealer territorial protection is necessary to induce dealers to supply pre-sale demonstration, promotion, or other informational services. As

explained in the U.S. Department of Justice Vertical Restraints Guidelines

[L]imiting the number of distribution outlets may be the most efficient method of insuring the provision of pre-sale demonstration and other informational services that consumers want and that are necessary to effective marketing of a technically complex product. In those circumstances, in the absence of vertical restraints a dealer may invest too little in such services because other dealers that do not provide the services may "free ride" on the services that the dealer has provided. By reducing the threat of free-riding, vertical restraints may enable a dealer to capture a significant fraction of the increase in total demand that is generated by his investment in informational services and, therefore, encourage dealers to expend the effort required to provide those services.<sup>35</sup>

This argument, like the economies of scale argument, assumes that the manufacturer rather than the market, should determine the appropriate mix of price and service available at the retail level:

The most comprehensive response to arguments like this is that competition should be the device which determines what the public really needs or wants. Take the claim that display facilities are needed. If the public prefers expensive shopping amenities to lower prices, it will pay the higher prices to have the greater amenities. If this is really what the public wants, a dealer which bets its capital that it can sell more by lowering prices and skipping the frills will either find that it makes less return on investment than it could by providing display facilities, or will fail entirely. Other dealers will continue providing showrooms only if it pays them to do so. If sizable numbers of customers use the display facilities of the high-priced dealer to shop and then buy from the low-priced dealer, the high-priced dealer will respond by cutting its display services and its prices.

This is what should happen. If the public generally, or some significant segment of it, would in fact prefer to skip the amenities and pay the lower price, and if some dealer is ready to risk its capital on a judgment that this is so, it would be a grave

distortion of the competitive process to allow the manufacturer to impose on all concerned its narrower conception of an orderly market.<sup>36</sup>

In addition, the mere existence of the free rider "problem" is open to debate. As noted in the Vertical Restraints Guidelines promulgated by the National Association of Attorneys General "the free ride phenomenon is much disputed among economists, especially with regard to certain products where servicing or product enhancement is highly unlikely."<sup>37</sup> The existence of the free rider problem also is disputed by industry sources.<sup>38</sup> In addition, Professor Comanor has noted that the free rider theory does not apply if the product and services can be sold separately. Nor does the theory apply to post sale services, such as delivery, repair and instructions on proper use of the product, because consumers are unlikely to be able to buy the product from one dealer and obtain these services from another.<sup>39</sup>

In addition, to the extent a free rider problem exists, it can be remedied by devices that are far more effective, and simultaneously less restrictive to intrabrand competition than vertically imposed airtight territorial insulation of dealers, "Draconian responses which, in effect, could convert a major segment of the economy into a mere pipeline."<sup>40</sup> For example

[M]any point-of-sale activities sought by the manufacturer -- for example, warranty service or other product service -- can be individually priced, rather than tied to product sales. The free-rider is then foreclosed by the pricing system. Others -- for example, point of sale promotion or advertising -- can be paid for in whole or part by the manufacturer through "co-op" programs or the like. Others -- full line displays, for example -- can be mandated by the manufacturer as a condition for continued dealing without imposing other vertical restraints

that may reduce price competition or product or service variety competition in other respects. And if some dealer separation is also needed, it need not be airtight. Primary responsibility, promotion payment pass over, or other such devices, reasonably calculated to meet the specific problem can be used.<sup>41</sup>

### 3. Historical Success

Vertical restraints are often justified on the grounds that (1) firms using them have succeeded in holding or increasing market share in the face of competition from larger rivals, (2) consumer prices have dropped in industries in which vertical market division is used,<sup>42</sup> or (3) firms which are adversely affected by vertical market division, such as discount stores and catalog showrooms, have thrived despite the use of vertical nonprice restraints.<sup>43</sup> This "historical success" argument in its various forms is among the flimsiest supporting vertical market division. First, it erroneously assumes a direct correlation between size of market share and commercial success.<sup>44</sup>

As Professor Sullivan notes:

The non sequitur is manifest; there is on the face of the matter no basis for inferring that the firm with 10, 15 or 20 percent of the market is earning greater returns on invested capital than is the firm with 6, 4 or 2 percent. Absent a claim that aggregate volume at these lower levels is below the most efficient scale, data about the percentage of the market held is simply not relevant to the question of whether profits are adequate.<sup>45</sup>

Second, the success argument equates the manufacturer's interest with the public interest.

[A]ctually, if a given manufacturer could prosper only when there are anticompetitive props insulating its dealers from intrabrand competition, it



may well be that the manufacturer's prosperity indicates a less than optimum allocation of resources.<sup>46</sup>

Third, and perhaps most importantly, historical success is simply irrelevant to the issue whether the vertical market division either is pro-competitive or in fact caused the claimed success. For example, an electronics industry representative recently asserted that "since the GTE Sylvania decision, color TV prices have dropped more than 10 percent."<sup>47</sup> This statement proves nothing. Color TV prices are affected by a wide variety of variables, which may or may not include the effects of restricted distribution policies adopted by some manufacturers. In addition, the statement provides no basis for asserting that GTE Sylvania benefits consumers. Without it, consumer electronics prices might have dropped far more. Conversely, the discount trade industry, which has admittedly flourished in the years since GTE Sylvania was decided, might have expanded even faster. The GTE Sylvania case itself also is instructive. In that case, Professor Preston, Sylvania's expert witness, admitted that there was no necessary connection between the use of a location clause and Sylvania's ability to maintain its market share, that there were many other reasons (new management, increased product quality, promotion and advertising) besides the location practice that could explain Sylvania's market share, and most importantly that it is impossible to specify given the present state of economic analysis, the impact of changes at the retail level on competition at the manufacturing level.<sup>48</sup>

#### 4. The Specter of Vertical Integration

Perhaps the most specious argument supporting vertical restraints is the prospect of substantial vertical integration by manufacturers into retailing if such restraints are proscribed. Justice Scalia, in Business Electronics, provided a classic formulation:

[T]he per se illegality of vertical restraints would create a perverse incentive for manufacturers to integrate vertically into distribution, an outcome hardly conducive to fostering the creation and maintenance of small businesses.<sup>49</sup>

This argument ignores economic reality. As eloquently noted by Judge Browning in his dissent in the Ninth Circuit's decision in GTE Sylvania:

"Predictions of vertical integration" because of antitrust condemnation of vertical restrictions "have proved to be remarkably unreliable in the past." It is unlikely that they would be more reliable in this instance. Producers distribute through independent dealers rather than through their own employees because it is economically advantageous to do so. Vertical integration by a producer into retail distribution is particularly uneconomic. Distribution is a relatively low profit activity. Both capital and operating costs are high. The product "mix" required in most retail operations cannot be furnished by a single producer: "Nobody is going to set up a distribution system to sell toothpaste, no matter what the antitrust laws say." . . . Moreover, independent businessmen often bring to distribution qualities such as a "sense of responsibility, industriousness, attention to costs and desire to earn a profit," which are not ordinarily found in salaried employees. Finally, franchising offers significant advantages in avoiding local labor problems, administrative burdens, and a variety of additional taxes. These substantial economic advantages of franchising will remain even if producers are prevented from dictating the territory in which independent dealers resell. The only reasonable prediction, therefore, is that if the district court were affirmed in this case, producers would continue to distribute through independent dealers rather than integrate forward.<sup>50</sup>

In addition, the "specter of vertical integration" argument assumes erroneously that vertical integration is somehow bad in itself or that vertical integration is less efficient than distribution through independent franchised retailers. But as Judge Browning noted:

The majority's suggestion that elimination of territorial restrictions might lead to the creation of large franchisees with several outlets, and that this result would be undesirable is nothing more than an argument against competition. Chain stores cannot be prohibited in the name of free competition. If chain franchisees succeed in free competition among independent businessmen making their own decisions, and without predatory conduct, neither the letter nor spirit of the Sherman Act will be offended.<sup>51</sup>

#### 5. Dealer Goodwill

Vertical market division is often justified as promoting dealer goodwill and encouraging dealer selling effort, thereby promoting interbrand competition. But, as Professor Sullivan notes:

We may assume, in general, that the more competition a dealer faces, the more vigorous will that dealer be obliged to be; and this holds true whether the competition is interbrand or intrabrand. A dealer worried about losing even those buyers with some pre-commitment to its brand will hustle more earnestly than a dealer free of intrabrand competition and which must worry about losing only those prospective customers who lack a clear preference for the brand. "Effort" is encouraged not by freeing a dealer from important competition pressures, but by subjecting each dealer to whatever competitive pressure the market generates.<sup>52</sup>

Given the insubstantial nature of the arguments supporting vertical market division, one might assume that few such arrangements survive the rule of reason scrutiny mandated by GTE Sylvania. In fact, however, because of the curious and unprecedented character of the "rule

of reason" analysis apparently sanctioned by GTE Sylvania, few nonprice vertical restraints now violate the law. The current approach to rule of reason analysis of vertical nonprice restraints is outlined below, followed by a discussion indicating how the rule of reason ought properly be applied in such cases.

### III. The Rule of Reason as Currently Applied to Vertical Restraints

#### A. Introduction

As previously noted, the "rule of reason" is the basic standard used to judge violations of § 1 of the Sherman Act; that is, only unreasonable restraints of trade are proscribed.<sup>53</sup> In most cases, therefore, the rule of reason requires an often elaborate judicial inquiry to determine whether the challenged practice unreasonably suppresses competition. The Supreme Court has, however, declared that certain specific practices or business relationships are so inherently destructive of competition that they are unreasonable "per se"; that is, they 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."<sup>54</sup> Per se illegality has been imposed, on a case by case basis, on a variety of conduct including horizontal price fixing,<sup>55</sup> vertical price fixing (resale price maintenance),<sup>56</sup> group boycotts,<sup>57</sup> certain tying arrangements,<sup>58</sup> and horizontal market division.<sup>59</sup>

In applying the rule of reason, Professor Areeda has suggested that virtually all courts apply a three-part analysis

(1) What harm to competition results or may result from the collaborators' activities? (2) What is the object they are trying to achieve and is it a legitimate and significant one? That is, what are the nature and magnitude of the "redeeming virtues" of the challenged collaboration? (3) Are there other and better ways by which the collaborators can achieve their legitimate objectives with fewer harms to competition? That is, are there "less restrictive alternatives" to the challenged restraint?<sup>60</sup>

Regarding whether different standards should apply under the "rule of reason" to horizontal and vertical restraints, Professor Areeda notes:

Although many vertical arrangements have characteristics distinguishing them in important ways from the bulk of horizontal arrangements, horizontal and vertical restraints do not always threaten competition in different ways, or call for different analysis. The horizontal-vertical classification is often helpful and convenient. But there is no need to define watertight and mutually exclusive classes of restraints. Whether horizontal or vertical, the question is always one of competitive effects and redeeming virtues. The horizontal-vertical distinction is relevant only insofar as it bears on the assessment of competitive evils or justifications.<sup>61</sup>

Professor Areeda explains the respective proof burdens of the parties under the rule of reason as follows:

To avoid dismissal, the plaintiff must allege that competition in a specified market has been restrained. To avoid adverse summary judgment, he must show that there are disputed material facts on that question. If such a restraint is shown, the burden passes to the defendant to offer evidence that a legitimate objective is served by the challenged behavior. That justification will be lost if the plaintiff shows that it can be achieved by a substantially less restrictive alternative. By this stage of the controversy, most cases will be resolved. If not, the harms and benefits must be balanced to reach a net judgment whether the challenged behavior is, on balance, reasonable. The plaintiff bears the burden of persuading the tribunal that an unreasonable restraint exists.<sup>62</sup>

As previously discussed, vertical market division schemes, under GTE Sylvania, are now governed by the rule of reason. One might assume, therefore, that the three-part harms-benefits-alternatives test used in virtually every other antitrust context, would be used to judge vertical market division. In fact, however, such an approach is not used because of the curious balancing test apparently authorized by GTE Sylvania. The sole justification for the GTE Sylvania holding is that the obvious reduction or elimination of intrabrand competition inherent in vertical market division, may be offset by a corresponding stimulation of interbrand competition. GTE Sylvania therefore requires that courts, in judging legality, balance any apparent harm to intrabrand competition against any claimed benefit to interbrand competition. This approach, as developed below, has two fatal flaws: (1) its basic premise has been categorically rejected in every other antitrust context in which it has been raised; and (2) it is incapable of discriminating judicial application and virtually assures victory to the defendant.

#### B. GTE Sylvania's Conflict with Prior Law

The skewed "rule of reason" analysis adopted in GTE Sylvania embodies a principle consistently rejected in other antitrust contexts: that courts should (or indeed are able to) balance anticompetitive effects of a restraint in one market against allegedly procompetitive effects in another to determine legality. For example, in the landmark horizontal merger case, United States v. Philadelphia National Bank (1963),<sup>63</sup> the Justice Department sought to enjoin the merger of

the second and third largest commercial banks in the four-county area including and surrounding Philadelphia. The defendants asserted, inter alia, that the increased lending limit of the resulting bank would enable it to compete with large out-of-state banks, particularly New York banks, for very large loans. In rejecting this contention, the Supreme Court stated:

We reject this application of the concept of "counter-vailing power," . . . Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 71 S.Ct. 259, 95 L.Ed. 219. If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it in the end as large as the industry leader.<sup>64</sup>

In addition, the notion that intrabrand competition may be sacrificed to foster interbrand rivalry was explicitly rejected by the court in its horizontal market division landmark, United States v. Topco Associates, Inc. (1972).<sup>65</sup> In this case, the defendants, a group of independent grocery store chains desired to sell a "house" or "private label" brand to enable them better to compete with national and regional supermarket chains. To this end they formed Topco to act as purchasing agent for goods to bear the Topco brand, and to license the individual members to sell those products. Of antitrust concern were provisions in Topco's bylaws granting member chains exclusive, or in fact exclusive, territorial licenses. Topco argued that the territorial division was necessary to meet larger chain competition. In rejecting this argument, and declaring the territorial division illegal, Justice Marshall noted:

[C]ourts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector is one important reason we have formulated per se rules.

In applying these rigid rules, the Court has consistently rejected the notion that naked restraints of trade are to be tolerated because they are well intended or because they are allegedly developed to increase competition. . . .

Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete--to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster. Implicit in such freedom is the notion that it cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy. . . .

The District Court determined that by limiting the freedom of its individual members to compete with each other, Topco was doing a greater good by fostering competition between members and other large supermarket chains. But, the fallacy in this is that Topco has no authority under the Sherman Act to determine the respective values of competition in various sectors of the economy. On the contrary, the Sherman Act gives to each Topco member and to each prospective member the right to ascertain for itself whether or not competition with other supermarket chains is more desirable than competition in the sale of Topco-brand products. Without territorial restrictions, Topco members may indeed "[cut] each other's throats." . . . But we have never found this possibility sufficient to warrant condoning horizontal restraints of trade.<sup>66</sup>

The court in GTE Sylvania would have been well advised to follow Justice Marshall's reasoning and reject the interbrand-intrabrand balancing test it adopted in GTE Sylvania. Subsequent experience with GTE Sylvania has ably demonstrated the fact that, indeed, courts are



unable "to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector."<sup>67</sup> In fact, most courts no longer even make the effort; rather, by attaching no value to the elimination of intrabrand competition, they have, as discussed below, effectively fashioned a rule of per se legality for most vertical restraints.

C. GTE Sylvania's Rule of Reason as Incapable of Judicial Application

Chicago School antitrust analysts assert that economic efficiency is the sole goal of antitrust law.<sup>68</sup> Others have asserted that Congress condemned the trusts and monopolies to prevent the unfair transfer of wealth from consumers to firms with market power.<sup>69</sup> Others have identified a broad range of social and political goals of the law.<sup>70</sup> With respect to vertical restraints, as Professor Cann notes,

antitrust enforcement is increasingly reflecting the values inherent in the efficiency approach and is increasingly restricting its concerns to economies of scale, efficiency-enhancing functions, threats of free riders, and interbrand competition.<sup>71</sup>

Professor Cann also notes that in applying the rule of reason to vertical restraints, "proponents of the efficiency approach tend to view 'reason' as an inherent, and readily assumable, component of any vertical restriction."<sup>72</sup> Given this predisposition, which is now shared by many in the judiciary, it is no surprise that the rule of reason as applied to vertical restraints is a toothless legal standard. Though some have attempted to breathe life into the standard,<sup>73</sup> it is apparent that the free floating cost-benefit analysis authorized by

GTE Sylvania, in which the obvious restraint on intrabrand competition is somehow balanced against purported interbrand benefits, is utterly incapable of principled judicial application. Indeed, this fact is acknowledged by the Chicago School in support of its argument to eliminate any judicial scrutiny of vertical restraints, price or non-price.<sup>74</sup> The GTE Sylvania approach suffers from the fundamental flaw inherent in all cost-benefit analysis: (1) what are costs and what are benefits depend solely upon one's point of view, and (2) even if costs and benefits can be distinguished, the proportionate weight attached to each is utterly arbitrary. The problem is well illustrated in the vertical restraint context. The Chicago School attaches no importance to intrabrand competition<sup>75</sup> and probably views its suppression as a "benefit" because of the alleged procompetitive impact of vertical restraints on interbrand competition. Others, who are supported by a number of Supreme Court opinions, including GTE Sylvania,<sup>76</sup> assert that intrabrand competition is indeed important and would view almost any intrabrand suppression as sufficient to condemn the restraint. In other words, free floating cost-benefit analysis prejudices the case depending almost solely upon the judge's opinion of the value of intrabrand competition. Because the Chicago School and many in the judiciary now assign virtually no weight to the suppression of intrabrand competition, the plaintiff automatically loses. That is, "rule of reason" becomes equated with "per se legality" in vertical restraint cases.

Another serious problem with the free floating cost-benefit standard for vertical restraints is that "courts are ill-equipped to

resolve the complex economic problems involved in deciding in a given case whether elimination of intrabrand competition among dealers through territorial restrictions in fact produced compensating gains in interbrand competition among producers."<sup>77</sup> As previously noted, economic analysis is unable to predict the effect that changes in marketing practices at one level of a market will have at other levels.<sup>78</sup> As accurately observed by Judge Browning in his cogent dissent to the Court of Appeals' opinion in GTE Sylvania:

If the courts were required to review such issues under a "rule of reason," unpredictable ad hoc determinations as to what is or is not illegal under the Sherman Act would result. . . .

A judge or jury should not be expected to determine whether Sylvania's locations practice contributed to Sylvania's success in interbrand competition when Sylvania's expert witness was unable to do so. Because the interbrand effects of Sylvania's location practice cannot be measured, a decision as to whether the net effect of the practice was procompetitive would be sheer guesswork.<sup>79</sup>

In addition to the problems of weighing complex and conflicting economic evidence, the free floating cost-benefit analysis of GTE Sylvania usurps to the courts a legislative function. As noted by the Supreme Court in Topco:

If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion, this too is a decision that must be made by Congress and not by private forces or by the courts. Private forces are too keenly aware of their own interests in making such decisions and courts are ill-equipped and ill-situated for such decision-making. To analyze, interpret, and evaluate the myriad of competing interests and the endless data that would surely be brought to bear on such decisions, and to make the delicate judgment on the

relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required.<sup>80</sup>

IV. A Discriminating Application of the Rule of Reason to Vertical Restraints

In contrast to the current free floating nonstandard, a discriminating application of the rule of reason under the traditional three part harm-benefit-alternative standard will proscribe many if not most vertical market division arrangements.

A. Harm to Competition

All vertical restraints, price or nonprice, intentionally and inevitably always restrict or eliminate intrabrand competition, which has long been protected by antitrust law.<sup>81</sup> Vertical restraint proponents assume, however, that intrabrand rivalry is irrelevant, that the manufacturer knows best what the appropriate product promotion, service, and price mix should be at all levels of distribution. Wholesalers and retailers are viewed as mere conduits who simply effectuate the manufacturer's preordained vision, and add no value or innovation of their own. In fact, of course, downstream firms do not merely as a closed pipeline from manufacturer to consumer.

Retailers make investments and add value themselves. They may vary in locational (and thus time) convenience, in the range of merchandise they keep in stock, in the kinds of information and personal service they offer, and in atmosphere and style. Because they add value in these ways, they use their suppliers' products as an "input," much as, say, a manufacturer of appliances uses machine parts as an "input." Different retailers combine a particular supplier's product with other elements to provide different, and alternative outputs, just as different appliance manufacturers differentiate their end

products, though many of the inputs are the same. At the downstream as well as at the manufacturer level, these differences increase the range of options open to consumers. . . . Moreover, innovation can occur downstream as well as at the manufacturing level. There have been numerous innovations in marketing, just as in production: the department store; the supermarket; the mail-order firm; the discount store; the boutique; and others come to mind. All have added to the variety and range of choice open to consumers. Many have served to reduce the cost of getting merchandise to the consumer.<sup>82</sup>

In short, consumers benefit from intrabrand as well as interbrand competition, both of which reduce price and promote cost-reducing efficiencies. "Any vertical restraint, by reducing intrabrand competition, is likely to cause a price increase, and to reduce the range of price-service-amenity options open to consumers."<sup>83</sup>

In addition to restricting or eliminating intrabrand competition, vertical restraints may: (1) facilitate collusion among suppliers or dealers or both under certain market conditions;<sup>84</sup> and (2) raise entry barriers, erect new entry barriers, and force competitors to operate inefficiently.<sup>85</sup> Further, because of their tendency to facilitate overt collusion and raise entry barriers, vertical restraints may reinforce patterns of consciously parallel behavior in oligopolistic markets.<sup>86</sup>

The foregoing anticompetitive consequences are in many cases supposedly outweighed by an enhancement of interbrand competition. Yet this basic premise, the sole basis of the GTE Sylvania holding, is itself highly controversial. For example, a number of economists have argued that because vertical market division enhances product differentiation, interbrand as well as intrabrand competition is reduced.<sup>87</sup>

In addition, the basic Chicago School assumption that vertical restraints enhance manufacturer profits only when consumers also receive net benefits from increased services--that is, that manufacturer and consumer interests fully correspond when vertical restraints are used<sup>88</sup>--has been severely criticized.<sup>89</sup> In sum, because vertical restraints always restrict or eliminate intrabrand competition, may have other anticompetitive consequences in certain market structures, and may not promote interbrand competition, it appears that on the "harm to competition" prong of rule of reason analysis, the plaintiff should prevail merely by proving the existence of the restraint.

B. The Purpose of the Restraint

The next element of traditional rule of reason analysis is to determine why the manufacturer adopted the vertical restraint; that is, which of the alleged procompetitive effects of vertical restraints did the manufacturer seek to foster in this case. On this issue, it would appear reasonable to require the defendant to provide some explanation of the business conditions and market forces which led to the adoption of the restraint and how the defendant believed it would solve the perceived problem, rather than, as noted by one court, to require the antitrust plaintiff "to conjure up every possible procompetitive rationale for a vertical restraint, and prove [its] inapplicability to the restraint in question."<sup>90</sup>

Of course, the Chicago School believes that the benefits of vertical restraints are so manifest that the restraints should be legal per se, requiring no justification. Yet despite this patent

obviousness, the Chicago School is utterly unable to answer the simple question of why the restraints have been adopted. For example, the Justice Department's roundly repudiated Vertical Restraints Guidelines<sup>91</sup> presume that an inability to demonstrate efficiencies should not condemn a restraint as anticompetitive because "efficiencies may be present but the firms may be unable to demonstrate them."<sup>92</sup> Regarding whether a legal basis exists for the Guidelines' claim that no adverse inference should be drawn from the defendant's inability to articulate a legitimate justification for the restraint, Professor Sullivan recently stated:

Not as a matter of law. Indeed, not even as a matter of Chicago School economics. The theoretical assumption is that traders are doing things to maximize profits. If the sponsor of a trade restraint cannot offer a plausible, innocent explanation the normal inference might well be that there is a non-innocent motive.<sup>93</sup>

Nevertheless, Professor, now Judge, Easterbrook opines:

Most business practices have some explanation, else they would not have survived. There is great difficulty in knowing what the explanation is in a particular case. Often the best anyone can do is offer a menu of possibilities, some pro- and some anti-competitive. When the anticompetitive explanations have been eliminated, the procompetitive explanations are left--although we still do not know which explanations matter. . . .

It really does not matter which explanation is "right." . . . For current purposes it does not matter why restricted dealing is used, once we have concluded that there is little likelihood of anticompetitive effect.<sup>94</sup>

Although the Chicago School is unable to find any anticompetitive consequences of vertical restraints, both the case law and common sense indicate that there are such consequences, most notably the

elimination of intrabrand competition--a form of competition which is protected by antitrust law. In justifying such a restraint even the most strident proponents of per se legality for restricted distribution are unable to offer more than a "menu of possibilities" among which "we still do not know which explanations matter." In no other area of the law is a defendant charged with illegal conduct permitted to justify that conduct by producing a laundry list of arguably exculpatory rationales, asking the court to choose one or more reasons from that list to excuse the challenged conduct, while offering no explanation of what particular benefit--such as reasonably specific anticipated efficiency gains, resolving an actual free rider problem, or actual provision of necessary sales expertise or service and repair facilities--the restraints hope to achieve in the context of the case. What is essential to a proper application of the rule of reason in a nonprice vertical restraints case is that the defendant articulate some reason justifying the use of the restraint that is capable of being considered and applied, as it must, in the context of a litigated case. By permitting all defendants using whatever variety or combination of vertical restraints to parade the same Chicago School laundry list of "coulds," "mights," and "mays" in justification before the trier of fact, and requiring the plaintiff to prove their inapplicability, the plaintiff is guaranteed defeat. Chicago School "analysis" in effect concludes that because some forms of vertical restraint may arguably benefit interbrand competition under some indefinable set of circumstances, all vertical restraints therefore should be legal under all circumstances.



C. Less Restrictive Alternatives

In applying the rule of reason, the court must determine whether there are alternatives, less restrictive of competition, available to achieve the asserted legitimate objectives of the restraint. For example, some degree of territorial insulation can be provided by a simple selective distribution system, under which the manufacturer unilaterally franchises only a limited number of sales outlets.<sup>95</sup> Another alternative, which is designed to achieve many of the same purposes alleged for vertical restraints (for example, to induce buyers to carry a product line and promote it vigorously), is the exclusive franchise--such an arrangement (also known as an exclusive selling, sole outlet, or exclusive dealership arrangement) involves a

promise by the seller not to sell to any dealer other than the franchisee in a designated territory which the franchisee expects to serve, and a further promise that the seller will not authorize any other dealer which makes sales in the territory to hold itself out as the seller's authorized representative there. These arrangements . . . involve a territorial restriction only upon the seller and are often used . . . in conjunction with primary responsibility clauses which obligate the dealer to serve the territory effectively.<sup>96</sup>

Although exclusive franchises do diminish intrabrand competition and should therefore not be free of antitrust scrutiny, particularly when used by a dominant firm, they have been upheld in a number of cases,<sup>97</sup> and are less restrictive to competition than airtight territorial restraints.<sup>98</sup> The manufacturer also may use a "profit passover" arrangement, also subject to rule of reason analysis, under which a dealer is required to compensate other dealers for sales made in their

territories (for example, to reimburse dealers for advertising, promotional, and post-sale service).

The current crabbed "rule of reason" analysis of nonprice vertical restraints takes no account of whether the defendant can achieve its distribution objectives in ways that are less restrictive to competition than full blown territorial insulation. Indeed, under the Chicago School approach, the manufacturer is not even required to articulate the specific objectives sought to be achieved by the restraints. This approach obviously makes it difficult for the trier of fact to examine whether less restrictive alternatives exist to achieve these objectives.

In sum, under the currently fashionable formulation of rule of reason analysis applied to vertical restraints, the deck is stacked against the plaintiff. The restraint on intrabrand competition is ignored, or worse, its elimination is viewed as a benefit to competition. The defendants point to facially plausible, though questionable, justifications for their conduct, but refuse or are unable to elaborate (except with arcane economic analysis certainly unknown to the manufacturer when it adopted the restraint) on which arguably procompetitive justification moved them to adopt the restraint in question. They are, of course, unable to show that their purposes in adopting the restraint could be achieved by less restrictive means because they are unwilling or unable to explain to the plaintiff or the court why they adopted the restraint in the first place. Based upon this "analysis," which assumes away objections to the restraint, and correspondingly assumes benefits, the Chicago School would fashion

a rule of per se legality. In fact, what the actual analysis shows is a clearly anticompetitive practice which the defendant cannot justify in the context of any specific case, except to opine what it "could," "might" or "may" do to promote interbrand competition.

D. Conclusion

As noted by Professor Areeda, the rule of reason often can be applied summarily, without elaborate fact-finding and with no requirement that every question of competitive effect, justification, or available alternatives be decided by the jury. That is, many cases can be resolved on the basis of the parties' arguments or a summary judgment record.<sup>99</sup> Vertical market division cases would appear to be a prime candidate for such an analysis especially given the assured harm to intrabrand competition, the controversial nature of the arguments supporting the restraints, and the defendant's inability or unwillingness to justify its conduct. That is, a discriminating rule of reason analysis would proscribe most restraints at the pleadings stage. Indeed, a return to a rule of per se illegality for nonprice vertical restraints (territory, customer, and location clauses) would not unduly hamper a supplier's effort to develop a distribution system and would greatly aid the administratability of the Sherman Act. As long ago noted by one commentator:

[H]undreds of manufacturers have for years been successfully operating under antitrust decrees forbidding precisely the same type of product control held per se illegal in Arnold, Schwinn & Co. Injunctive provisions of this type have long been standard in Department of Justice consent and litigated decrees.<sup>100</sup>

V. The Sad Legacy of GTE Sylvania--The Dealer Termination Cases

If GTE Sylvania had been confined to its holding--that nonprice vertical restraints are judged under rule of reason rather than per se analysis--it would not be the pernicious decision it has become, because most such restraints cannot survive a rigorous rule of reason analysis. The Chicago School, however, has latched onto it as portending a major shift in antitrust doctrine, toward legalizing all vertical restraints, price and nonprice.<sup>101</sup> Perhaps more importantly, GTE Sylvania and the Supreme Court's curious decisions in Monsanto Company v. Spray-Rite Service Corporation (1984),<sup>102</sup> and Business Electronics Corporation v. Sharp Electronics Corporation (1988)<sup>103</sup> have had a particularly debilitating effect upon antitrust enforcement in a seemingly only tangentially related area--cases involving termination of one dealer at the request of another. Professor Sullivan eloquently explained the difference between the exclusive franchise which may or may not survive antitrust scrutiny under the rule of reason, and dealer induced terminations of competitors:

It does not follow from the fact that a manufacturer may, when franchising a dealer, commit itself not to franchise another in a territory defined by the manufacturer, that it may, having earlier franchised two or more dealers, agree at the request of one to terminate the others. It is not merely that the latter promise liquidates palpable interests of existing traders, while the former does not (a difference which is real enough, and which is charged with meaning for the procedural and damage aspects of the law); it is also that the competitive effect of the first promise is less severe than that of the second. The first commitment forecloses potential intrabrand competition only; the second stamps out existing competition at the behest of a firm which is suffering under it.<sup>104</sup>

Despite this important difference, the Court in Monsanto and Business Electronics has, through a reckless infusion of GTE Sylvania rhetoric, created a monster, which has, as developed below, wreaked havoc on the law governing dealer termination.

A. Monsanto

In Monsanto, Spray-Rite was a wholesale distributor of agricultural chemicals, including herbicides manufactured by Monsanto. Spray-Rite was described by the Court as a "discount operation, buying large quantities and selling at a low margin."<sup>105</sup> After being terminated, Spray-Rite sued under § 1 alleging that it had been terminated pursuant to a conspiracy between Monsanto and some of its other distributors to fix the resale prices of Monsanto herbicides. The jury agreed. The Court of Appeals affirmed,<sup>106</sup> noting that there was sufficient evidence to satisfy Spray-Rite's burden of proving a conspiracy to set resale prices noting that "proof of termination following competitor complaints is sufficient to support an inference of concerted action."<sup>107</sup> In reviewing the evidence, the court found evidence of numerous complaints from competing Monsanto distributors about Spray-Rite's price cutting practices, and noted testimony of a Monsanto official that Spray-Rite was terminated because of the price complaints.

The Supreme Court granted certiorari and initially noted that two important distinctions must be made in distributor termination cases.

First, there is the basic distinction between concerted and independent action. . . . Independent action is not proscribed. A manufacturer of course generally has a right to deal, or refuse to deal,

with whomever it likes, as long as it does so independently. United States v. Colgate & Co., 250 U.S. 300, 307, 39 S.Ct. 465, 468 (1919). . . . Under Colgate, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination.

The second important distinction in distributor-termination cases is that between concerted action to set prices and concerted action on nonprice restrictions. The former have been per se illegal since the early years of national antitrust enforcement. See Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 404-409, 31 S.Ct. 376, 383-385, 55 L.Ed. 502 (1911). The latter are judged under the rule of reason, which requires a weighing of the relevant circumstances of a case to decide whether a restrictive practice constitutes an unreasonable restraint on competition. See Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977).<sup>108</sup>

The Court then went on to conclude:

A manufacturer and its distributors have legitimate reasons to exchange information about the prices and the reception of their products in the market. Moreover, it is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' resale prices. The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that "free-riders" do not interfere. . . . Thus, the manufacturer's strongly felt concern about resale prices does not necessarily mean that it has done more than the Colgate doctrine allows. . . .

Permitting an agreement to be inferred merely from the existence of complaints, or even from the fact that termination came about "in response to" complaints, could deter or penalize perfectly legitimate conduct. As Monsanto points out, complaints about price cutters "are natural--and from the manufacturer's perspective, unavoidable--reactions by distributors to the activities of

their rivals." . . . Moreover, distributors are an important source of information for manufacturers. In order to assure an efficient distribution system, manufacturers and distributors constantly must coordinate their activities to assure that their product will reach the consumer persuasively and efficiently. To bar a manufacturer from acting solely because the information upon which it acts originated as a price complaint would create an irrational dislocation in the market. . . . In sum, "[t]o permit the inference of concerted action on the basis of receiving complaints alone and thus to expose the defendant to treble damage liability would both inhibit management's exercise of its independent business judgment and emasculate the terms of the statute." [Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 n. 2 (3rd Cir. 1980), cert. denied, 101 S.Ct. 1981 (1981).]

Thus, something more than evidence of complaints is needed. There must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently. As Judge Aldisert has written, the antitrust plaintiff should present direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others "had a conscious commitment to a common scheme designed to achieve an unlawful objective." Edward J. Sweeney & Sons, supra, at 111.<sup>109</sup>

Applying this standard to the facts, the Court found sufficient evidence to support the jury finding of unlawful conspiracy.

Although the Court reached the right result in Monsanto, its reasoning utterly obscures the basic issue in such cases and makes it much more difficult for a plaintiff to recover. Monsanto, like most cases following it, is an almost classic horizontal group boycott. A group of competitors at one functional level (here, the complaining Monsanto distributors) desire, for whatever reason (here, as in most cases, discount pricing) to eliminate a competitor at their level (here, Spray-Rite). To achieve their purpose the conspirators exert pressure at a functional level above or below their own (here, at the

supplier level) to induce, usually coercively, a market participant at that level to deprive the disfavored competitor of an essential trade relationship it needs to compete with those conspiring. Note how strikingly different this situation is from the issue addressed in GTE Sylvania--whether a contractually imposed location clause should be per se illegal or governed by the rule of reason under antitrust law. It is one thing to contractually foreclose potential intrabrand competition; it is quite another to stamp out existing competition through a coercive combination consisting of a firm (or firms) suffering from the competition and its (their) supplier.<sup>110</sup>

Despite this basic distinction, the Court in Monsanto proceeded as if the legality of Monsanto's distribution system was in issue, speaking of: manufacturer attempts to further a "particular marketing strategy" through "costly nonprice restrictions" designed to ensure distributors a sufficient profit to pay for additional personnel or product related services; efforts to eliminate the ubiquitous "free rider"; and the requirement of coordinated activities between manufacturers and distributors in pursuit of an "efficient distribution system." Of course, all of this GTE Sylvania rhetoric is irrelevant to the issue presented in Monsanto--when is a jury permitted to infer that a supplier's action in terminating a distributor is concerted rather than independent? Nevertheless, to prevent a hypothetical manufacturer from being inhibited in the exercise of its independent business judgment regarding a hypothetical distribution system not at issue in the case, the Monsanto court thought it necessary to erect a double barreled burden of proof standard for plaintiffs in cases



involving termination of one dealer at the request of another. That is, under Monsanto: "not only must a plaintiff seeking for each the jury prove a conspiracy, but he also must disprove the existence of any or all hypothetical explanations for the manufacturer's conduct that 'might justify a dealer termination',"<sup>111</sup> explanations invariably drawn from the laundry list of arguably procompetitive consequences of nonprice vertical restraints outlined in GTE Sylvania. The approach sanctioned in Monsanto obscures the boycott nature of the dealer termination cases, and erects unprecedented and virtually insurmountable evidentiary barrier to plaintiff recovery in such cases.

1. The Error of Monsanto--Mischaracterization of Horizontal as Vertical

The most basic, fundamental, and pernicious error of Monsanto is its failure to recognize that the restraint involved is a horizontal price restraint not a vertical nonprice restraint. This point was observed by Justice Stevens in the first paragraph of his dissent in Business Electronics:

In its opinion the majority assumes, without analysis, that the question presented by this case concerns the legality of a "vertical nonprice restraint." As I shall demonstrate, the restraint that results when one or more dealers threatens to boycott a manufacturer unless it terminates its relationship with a price-cutting retailer is more properly viewed as a "horizontal restraint." Moreover, an agreement to terminate a dealer because of its price cutting is most certainly not a "nonprice restraint." The distinction between "vertical nonprice restraints" and "vertical price restraints," on which the majority focuses its attention, is therefore quite irrelevant to the outcome of this case. Of much greater importance is the distinction between "naked restraints" and "ancillary restraints" that has been a part of our law since the

landmark opinion written by Judge (later Chief Justice) Taft in United States v. Addyston Pipe & Steel Co., 85 F. 271 (CA6 1898), aff'd, 175 U.S. 211, 20 S.Ct. 96, 44 L.Ed. 136 (1899).<sup>112</sup>

The Supreme Court recognized this distinction clearly in United States v. General Motors Corporation (1966),<sup>113</sup> a classic case decided long before the debilitating influence of GTE Sylvania. In this case, certain franchised Los Angeles area Chevrolet dealers sold some of their cars through "referral outlets" or "discount houses," which sold at prices lower than those charged by many franchised dealers. After numerous dealer complaints, General Motors telephoned all area dealers, both to identify those associated with the discounters and to induce the offenders to stop dealing with the discounters. GM, through coercion, quickly elicited from each dealer its promise to refrain from dealing with the discounters.<sup>114</sup> To police the agreement GM and its dealer associations jointly financed "shopping" of the discounters, which was successful in assuring that no Chevrolet dealer continued to supply them with cars. This arrangement too relied upon coercion of offenders.<sup>115</sup>

At trial, General Motors argued that the dealers' involvement with discounters violated a location clause in the franchise agreement by establishing unauthorized additional sales outlets. GM further argued that the clause was lawful and that General Motors, its dealers and their associations, were merely seeking to vindicate a legitimate interest in uniform compliance with the franchise agreement. The Court rejected this argument noting:

We need not reach these questions concerning the meaning, effect, or validity of the "location clause" or of any other provision in the Dealer Selling Agreement, and we do not. We do not decide whether the "location clause" may be construed to prohibit a dealer, party to it, from selling through discounters, or whether General Motors could by unilateral action enforce the clause, so construed. We have here a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose. Against this fact of unlawful combination, the "location clause" is of no avail. Whatever General Motors might or might not lawfully have done to enforce individual Dealer Selling Agreements by action within the borders of those agreements and the relationship which each defines, is beside the point. . . .

Neither individual dealers nor the associations acted independently or separately. The dealers collaborated, through the associations and otherwise, among themselves and with General Motors, both to enlist the aid of General Motors and to enforce dealers' promises to forsake the discounters. . . .

There can be no doubt that the effect of the combination or conspiracy here was to restrain trade and commerce within the meaning of the Sherman Act. Elimination, by joint collaborative action, of discounters from access to the market is a per se violation of the Act.<sup>116</sup>

After discussing the group boycott cases, some of which did not involve price fixing,<sup>117</sup> the Court further noted:

The principle of these cases is that where businessmen concert their actions in order to deprive others of access to merchandise which the latter wish to sell to the public, we need not inquire into the economic motivation underlying their conduct. . . . Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be

saved by reference to the need for preserving the collaborators' profit margins or their system for distributing automobiles.<sup>118</sup>

Regarding the motive for the conspiracy, the Court observed:

[I]nherent in the success of the combination in this case was a substantial restraint upon price competition--a goal unlawful per se when sought to be effected by combination or conspiracy. . . . There is in the record ample evidence that one of the purposes behind the concerted effort to eliminate sales of new Chevrolet cars by discounters was to protect franchised dealers from real or apparent price competition. The discounters advertised price savings. . . . Some purchasers found and others believed that discount prices were lower than those available through the franchised dealers. . . . Certainly, complaints about price competition were prominent in the letters and telegrams with which the individual dealers and salesmen bombarded General Motors. . . .

The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws. We cannot respect that solicitude by closing our eyes to the effect upon price competition of the removal from the market, by combination or conspiracy, of a class of traders. Nor do we propose to construe the Sherman Act to prohibit conspiracies to fix prices at which competitors may sell, but to allow conspiracies or combinations to put competitors out of business entirely.<sup>119</sup>

The same reasoning as that outlined above should have been used to resolve Monsanto and the unfortunate collection of cases which follow it. Monsanto, however, wrongfully characterizes the problem as vertical rather than horizontal, rather than focusing upon the existence of, in the words of Justice Fortas in General Motors, "a classic conspiracy in restraint of trade."<sup>120</sup>

The Chicago School is fond of rejecting "formalistic distinctions,"<sup>121</sup> requiring instead a showing of "demonstrable economic effect"<sup>122</sup> to justify departure from a rule of reason standard. What,

however, could be more formalistic than the Chicago School's current approach to price related dealer terminations? They characterize the restraint as vertical simply because the act implementing the restraint (the manufacturer terminating the price cutter) comes from above. But, of course, this is exactly how the classic group boycott works. A competitor or group of competitors, in order to eliminate a competitor at their level, exert pressure on a functional level above or below them to induce a supplier or customer of the boycott victim not to deal with him. Further, as previously outlined,<sup>123</sup> no pro-competitive "demonstrable economic effect" can be shown or is even attempted to justify such a "vertical" restraint. In contrast, there are certain and easily provable adverse economic consequences, such as fewer choices and higher prices for consumers, flowing from wholly successful efforts by competitors to drive price cutting rivals out of business.<sup>124</sup>

## 2. The Error of Monsanto--Abrogation of the Jury Function

Monsanto compounds its error by wrongfully focusing upon the purported benefits of vertical restraints and then using these alleged benefits as a means of justifying a heightened burden of proof upon the injured plaintiff in dealer termination cases. As developed below, this burden usurps the function of the jury regarding conspiracy issues they are best qualified to resolved. More importantly, the strange mix of GTE Sylvania and Monsanto virtually insulates from any judicial scrutiny the type of coercive horizontal combination condemned in General Motors.

Before Monsanto, the courts of appeals were split regarding the amount of evidence necessary to support a jury inference that a dealer termination was the result of a conspiracy between the manufacturer and complaining distributors rather than the unilateral action of the manufacturer. As explained in the House Report accompanying the "Freedom from Vertical Pricing Fixing Act of 1987":<sup>125</sup>

Approaches varied widely, with some courts apparently taking the view that evidence of termination following competitor complaints was sufficient to create a jury issue of conspiracy,<sup>126</sup> and others apparently requiring evidence of "something more." Those courts requiring "something more" most commonly phrased their requirements in terms of a "causal connection" between the complaints and the termination.<sup>127</sup> Some courts, however, intimated that even a showing of causation might be insufficient to permit the jury to infer the requisite vertical conspiracy between the seller and the complaining distributors.<sup>128</sup> Others simply failed to make clear what standard they were applying.<sup>129</sup>

In Monsanto, the Court fashioned its own standard under which no inference of conspiracy may be drawn by the jury either from evidence that a price cutting dealer was terminated following complaints of other dealers, or from evidence that the termination was "in response to" such complaints.<sup>130</sup> Rather, the court reasoned that applying these standards without "something more" would undermine the Colgate doctrine,<sup>131</sup> which permits a manufacturer unilaterally to determine with whom it will deal.<sup>132</sup> The "something more" required by the plaintiff is "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."<sup>133</sup> That is, "direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others 'had a conscious

commitment to a common scheme designed to achieve an unlawful objective'."134

In formulating this test, the Monsanto Court relied upon the Third Circuit's majority opinion in Edward J. Sweeney & Sons, Inc. v. Texaco, Inc. (1980)<sup>135</sup> In Texaco, like Monsanto, a price cutting distributor (Sweeney) was terminated after Sweeney's competitors vigorously and frequently complained to Texaco about Sweeney's price cutting activities. Sweeney attempted to prove that Texaco unlawfully conspired with other fuel distributors and retailers to fix the price of Texaco gasoline. The district court found that Sweeney had failed to introduce evidence from which a jury could infer the existence of a conspiracy and therefore directed a verdict in favor of Texaco. The Court of Appeals affirmed, using the standard later adopted in Monsanto. Judge Sloviter filed a dissent in Texaco, which ably highlights the bankruptcy of the majority approach, and by derivation the grievous error of Monsanto itself. Judge Sloviter's disageement focused on two issues: first, that the majority had adopted an unduly restrictive interpretation concerning the quantum of evidence needed to bring action within § 1 of the Sherman Act; and second, that the majority abrogated to itself the jury's function of determining which inferences can reasonably be drawn from the evidence before it.

On the first issue he argued that the majority "retreats from prior decisions of this court, disregards the realities of market behavior, and ignores the virtual impossibility of producing direct evidence of unlawful combinations."<sup>136</sup> Initially Judge Sloviter noted that the case law is "replete"<sup>137</sup> with cases like General Motors or

Texaco in which a competitor or group of competitors, rather than meet its competition in the marketplace, attempt to "thrust at the jugular"<sup>138</sup> of the discounter's price competition by complaining to their mutual supplier in an effort to induce the supplier to control the discounter or terminate its source of supply.<sup>139</sup> He noted that most of these cases had addressed the issue of whether the conduct involved was "per se" illegal, and

until now, there has not been any serious question in this circuit that the competitors' complaints to the supplier about the discounter's market behavior and the supplier's action in response thereto are sufficient to constitute the "combination" necessary to bring the matter within the scope of section 1 of the Sherman Act.<sup>140</sup>

Judge Sloviter then noted that the majority's contrary holding was unsupported by any authority and that other courts had taken a more realistic view of the impact of complaints by competitors and the reaction of the manufacturer.<sup>141</sup> Judge Sloviter then continued

It is difficult to understand why the majority seriously contends that if a manufacturer reacts to complaints by its customers by cutting off the offending discounter or otherwise hampering its competition, this is not sufficient to establish a conspiracy or combination. A long and unbroken series of decisions has established that action which on the surface appears to be unilateral behavior can be considered to be part of a combination when viewed in light of the surrounding circumstances.<sup>142</sup>

On the second issue Judge Sloviter, after reviewing the evidence, concluded that a jury could well find that Texaco had acted in response to the numerous complaints it had received, but that the majority had usurped the jury's legitimate fact finding function.



The majority concludes that there was no credible evidence from which a jury could permissibly infer that Texaco's actions were in response to these complaints. In drawing this conclusion, the majority excerpts some of the testimony on which plaintiffs rely and combs through it to see what weight or credibility can be attached to it. The pertinent issue, of course, is not what the majority deems to be the reasonable inferences that can be drawn from the testimony but what the jury believes to be the reasonable inferences that can be drawn from the testimony. . . .

Although the majority purports to take cognizance of the difficulty of proving an anti-trust conspiracy by direct evidence, the effect of its decision will be to require nothing less than direct evidence of a causal connection between Sweeney's competitors' complaints and Texaco's actions. . . . It cannot be so naive as to expect that a sophisticated business concern like Texaco will have maintained records which make such a direct causal connection, or that its officers, well trained in the technicalities of the antitrust laws, will testify to that effect. The courts have recognized that "in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot." Poller v. Columbia Broadcasting System, Inc., 368 U.S. 464, 473, 82 S.Ct. 486, 491 (1962). . . .

The need to show that defendants' actions were part of a combination of conspiracy which falls within § 1 of the Sherman Act must be approached realistically, with an understanding of the various threads from which the fabric of business decisions are woven. If we are unwilling to allow the jury, which brings the community's experience to the fact finding process, to exercise its own judgment in making the reasonable inferences from the evidence, we will have unduly, and I think unwisely restricted its function in antitrust cases.<sup>143</sup>

By early 1986, Monsanto had been cited in over 60<sup>144</sup> reported vertical restraint cases. As Judge Sloviter predicted, plaintiffs in dealer termination cases have been unduly restricted in their ability

to recover, often banished from the court on summary judgment or directed verdict motions.<sup>145</sup> As noted in the House Report accompanying the "Freedom from Vertical Price Fixing Act of 1987":<sup>146</sup>

A striking feature of these cases is that a majority have involved rulings for summary judgments or directed verdicts in favor of defendant-manufacturers. While many of the decisions briefly acknowledged the accepted tenet that "summary proceedings should be used sparingly in complex litigation where motive and intent play leading role . . .,"<sup>147</sup> many of the same courts nevertheless granted, or affirmed the granting of, summary judgment. The basis for using a summary judgment disposition "sparingly" is rooted in two basic sources: the right to a jury trial on contested matters of fact, and the general philosophy of the Federal Rules of Civil Procedure, which seeks to filter out only those suits that are clearly frivolous, or harassing or in which there is no genuine issue for trial. Surprisingly, these issues did not figure significantly in the decisionmaking calculus of much of the post-Monsanto litigation.<sup>148</sup>

Another untoward consequence of the Monsanto standard is that it provided no adequate evidentiary criteria for subsequent litigation.

It was not very difficult to predict that confusion would abound in the federal circuits when the Supreme Court intimated that "something more" would be required in proving causation, even if such termination was "in response to" a price complaint.<sup>149</sup>

The courts of appeals have been left to decide for themselves the appropriate dividing line between judge and jury functions in dealer termination cases, resulting in a "confusing welter of lower court semantic formulations."<sup>150</sup> Indeed, the Supreme Court itself has had difficulty characterizing the Monsanto test.<sup>151</sup>

#### B. Business Electronics

The net effect of Monsanto and the lower court opinions applying it, which give disproportionate deference to the formerly closely

circumscribed Colgate doctrine, is to render vertical price fixing conspiracies virtually impossible to prove. Price related dealer terminations or refusals to supply are now commonplace, as both the number of post-Monsanto cases and industry sources<sup>152</sup> indicate.

Nevertheless, in Business Electronics Corporation v. Sharp Electronics Corporation (1988)<sup>153</sup> the Supreme Court compounded the error it made in GTE Sylvania and Monsanto by erecting yet another procedural barrier to plaintiff recovery in dealer termination cases. In this case, in 1968, respondent Sharp Electronics Corporation appointed petitioner Business Electronics Corporation as the exclusive retailer in Houston, Texas of Sharp's electronic calculators. In 1972, Sharp appointed Gilbert Hartwell as a second retailer of its calculators in Houston. Although Sharp published a list of suggested minimum retail prices, the retailers were not required to adhere to the price list, and Sharp imposed no nonprice vertical restraints on its dealers. Business Electronics usually sold Sharp calculators at prices lower than Sharp's suggested minimum prices and lower than those charged by Hartwell. In June 1973, after complaining to Sharp about Business Electronic's prices on several occasions, Hartwell notified Sharp that he would terminate his dealership unless Sharp ended its relationship with Business Electronics within 30 days. Sharp terminated the Business Electronics dealership in July, 1973.

Business Electronics sued Sharp and Hartwell alleging that they had conspired to terminate its dealership in violation of § 1 of the Sherman Act. The trial court instructed the jury that an agreement to terminate a dealer because of price cutting was a per se violation of

§ 1. The jury found for Business Electronics and awarded damages of \$600,000. On appeal, the Fifth Circuit Court of Appeals reversed, holding that an agreement between a manufacturer and dealer to terminate another dealer was a per se violation of § 1 of the Sherman Act only if the agreement required the surviving dealer to set prices at a particular level. In an opinion by Justice Scalia, the Supreme Court affirmed reasoning

Our approach to the question presented in the present case is guided by the premises of GTE Sylvania and Monsanto: that there is a presumption in favor of a rule-of-reason standard; that departure from that standard must be justified by demonstrable economic effect, such as the facilitation of cartelizing, rather than formalistic distinctions; that interbrand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of GTE Sylvania. These premises lead us to conclude that the line drawn by the Fifth Circuit is the most appropriate one. . . .

The District Court's rule on the scope of per se illegality for vertical restraints would threaten to dismantle the doctrine of GTE Sylvania. Any agreement between a manufacturer and a dealer to terminate another dealer who happens to have charged lower prices can be alleged to have been directed against the terminated dealer's "price cutting." In the vast majority of cases, it will be extremely difficult for the manufacturer to convince a jury that its motivation was to ensure adequate services, since price cutting and some measure of service cutting usually go hand in hand. Accordingly, a manufacturer that agrees to give one dealer an exclusive territory and terminates another dealer pursuant to that agreement, or even a manufacturer that agrees with one dealer to terminate another for failure to provide contractually-obligated services, exposes itself to the highly plausible claim that its real motivation was to terminate a price cutter. Moreover, even vertical restraints that do not result in dealer termination, such as the initial granting of an exclusive territory or the requirement that certain services be provided, can be attacked as

designed to allow existing dealers to charge higher prices. Manufacturers would be likely to forego legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties. . . .

Finally, we do not agree with petitioner's contention that an agreement on the remaining dealer's price or price levels will so often follow from terminating another dealer "because of [its] price cutting" that prophylaxis against resale price maintenance warrants the District Court's per se rule. Petitioner has provided no support for the proposition that vertical price agreements generally underlie agreements to terminate a price cutter. That proposition is simply incompatible with the conclusion of GTE Sylvania and Monsanto that manufacturers are often motivated by a legitimate desire to have dealers provide services, combined with the reality that price cutting is frequently made possible by "free riding" on the services provided by other dealers. The District Court's per se rule would therefore discourage conduct recognized by GTE Sylvania and Monsanto as beneficial to consumers.

. . .

In sum, economic analysis supports the view, and no precedent opposes it, that a vertical restraint is not illegal per se unless it includes some agreement on price or price levels. . . .<sup>154</sup>

Once again, as in Monsanto, the Court uses GTE Sylvania-style rhetoric to address an issue not presented by the case. Sharp imposed no nonprice vertical restraints on its dealers; rather, a naked horizontal price restraint was involved.<sup>155</sup> As noted by Justice Stevens in dissent

This therefore is not a case in which a manufacturer's right to grant exclusive territories, or to change the identity of the dealer in an established exclusive territory, is implicated. The case is one in which one of two competing dealers entered into an agreement with the manufacturer to terminate a particular competitor without making any promise to provide better or more efficient services and without receiving any guarantee of exclusivity in the future. . . .

The termination was motivated by the ultimatum that respondent received from Hartwell and that ultimatum, in turn, was the culmination of Hartwell's complaints about petitioner's competitive price cutting. The termination was plainly the product of coercion by the stronger of two dealers rather than an attempt to maintain an orderly and efficient system of distribution.

In sum, this case does not involve the reasonableness of any vertical restraint imposed on one or more dealers by a manufacturer in its basic franchise agreement. What the jury found was a simple and naked "'agreement between Sharp and Hartwell to terminate Business Electronics because of Business Electronics' price cutting.'" . . .<sup>156</sup>

In addition to the mischaracterization problem, Business Electronics, like Monsanto and its progeny, usurps the jury's fact-finding function. At trial, after hearing several days of testimony, the jury concluded that Sharp's defense that it had unilaterally terminated Business Electronics because of its poor sales performance was "pretextual."<sup>157</sup> Justice Stevens noted that neither the majority nor the Court of Appeals questioned the accuracy of the jury's resolution of the factual issues, but that

Nevertheless, the rule the majority fashions today is based largely on its concern that in other cases juries will be unable to tell the difference between truthful and pretextual defenses. Thus, it opines that "even a manufacturer that agrees with one dealer to terminate another for failure to provide contractually-obligated services, exposes itself to the highly plausible claim that its real motivation was to terminate a price cutter." . . . But such a "plausible" concern in a hypothetical case that is so different from this one should not be given greater weight than facts that can be established by hard evidence. If a dealer has, in fact, failed to provide contractually obligated services, and if the manufacturer has, in fact, terminated the dealer for that reason, both of those objective facts should be provable by admissible evidence. Both in its disposition of this

case and in its attempt to justify a new approach to agreements to eliminate price competition, the majority exhibits little confidence in the judicial process as a means of ascertaining the truth.<sup>158</sup>

In addition, also like Monsanto and its progeny, Business Electronics fails to attach any weight to the value of intrabrand competition.

As noted by Justice Stevens, nothing in GTE Sylvania implied that intrabrand competition could be eliminated without some evidence of a purpose to improve interbrand competition.<sup>159</sup> GTE Sylvania addressed the legality of manufacturer attempts to provide some territorial insulation to its dealers as part of an overall product distribution system. These attempts the court found should be judged by the rule of reason because of purported interbrand benefits of the restraints.

As noted by Justice Stevens, nowhere did GTE Sylvania

discuss the benefits of permitting dealers to structure intrabrand competition at the retail level by coercing manufacturers into essentially anticompetitive agreements. Thus, while Hartwell may indeed be able to provide better services under the sales franchise agreement with petitioner out of the way, one would not have thought, until today, that the mere possibility of such a result--at the expense of the elimination of price competition and absent the salutary overlay of a manufacturer's distribution decision with the entire product line in mind--would be sufficient to legitimate an otherwise purely anti-competitive restraint.<sup>160</sup>

In addition to the foregoing, Business Electronics suffers from an even more fundamental flaw--its holding that an agreement between a manufacturer and a dealer to terminate a second dealer is per se illegal only if the surviving dealer expressly or impliedly agrees to set its prices at some level. Initially, as previously noted,<sup>161</sup> such proof will be virtually impossible for the plaintiff to adduce. More

importantly, the Supreme Court has never heretofore sanctioned such a restrictive view of price fixing and indeed, one of the most fundamental premises of § 1 jurisprudence, articulated in a number of landmark decisions, is that any conduct which has the purpose and effect of restraining price movement and the free play of market forces is per se illegal. For example, in the antitrust classic, United States v. Socony-Vacuum Oil Co. (1940),<sup>162</sup> a case in which the conspirators manipulated spot market oil prices by concertedly purchasing excess supply, the Court stated:

any combination which tampers with price structure is engaged in an unlawful activity. . . . [It is not] important that the prices paid by the combination were not fixed in the sense that they were uniform and inflexible. Price-fixing . . . has no such limited meaning. An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements to raise or lower prices whatever machinery for price-fixing was used. . . . Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.<sup>163</sup>

And, as more recently noted by Justice Stevens in National Society of Professional Engineers v. United States (1978):<sup>164</sup>

"Price is the 'central nervous system of the economy,' and an agreement that 'interfere[s] with the setting of price by free market forces' is illegal on its face."<sup>165</sup>

It is barely arguable to assert that the coercive dealer terminations involved in Monsanto, Business Electronics, and their ilk, do not involve horizontal price fixing in the classic sense. The sole purpose of the agreement is to eliminate the price competition of a competitor



of one of the conspirators, thereby enabling that conspirator to charge a higher price. Clearly, this involves "tamper[ing] with price structures" or "interfere[nce] with the setting of price by free market forces." Yet the strange mix of GTE Sylvania, Monsanto, and Business Electronics virtually insulates this type of conduct from any judicial scrutiny under § 1 of the Sherman Act.

The Court's current characterization of the dealer termination cases as vertical conspiracies to fix resale prices rather than horizontal group boycotts would be unobjectionable if the Court had adopted a broad common-sense definition of resale price maintenance. In Business Electronics, however, the Court adopts an unprecedented and unduly restrictive definition of resale price maintenance, thereby clearly undermining Dr. Miles' per se prohibition of vertical price restraints. Contrast, for example, the Business Electronics approach, with the following definitions of resale price maintenance:

[A] RPM violation will equally lie (1) where a conspiracy exists between a supplier or distributor to eliminate or restrict a distributor's full latitude to determine prices that he will charge; (2) where a conspiracy exists between a supplier and a distributor to eliminate or restrict the freedom of a second distributor to freely determine what price he will charge; or (3) where a conspiracy exists between a supplier and distributor to terminate or cut off supply to a second distributor because of the second distributor's pricing policies. . . . Quite simply, if the purpose or effect of concerted activity is to affect or stifle price competition in any manner, then vertical price fixing is at issue; and the per se rule is the applicable test.<sup>166</sup>

A RPM agreement is reached when two or more independent firms agree to fix, raise, lower, maintain or stabilize the price at which goods or services will be resold.<sup>167</sup>

Note that under the broad definitions of resale price maintenance outlined above, agreement on specific resale prices is not required. This result is supported by United States v. Parke, Davis and Company,<sup>168</sup> in which the court, quoting United States v. Socony-Vacuum Oil Co. (1940),<sup>169</sup> a case involving horizontal price fixing, held that Parke Davis's coercion of retailers and wholesalers to maintain resale prices created a price maintenance combination or conspiracy in violation of the Sherman Act, and "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se."<sup>170</sup>

The Supreme Court apparently retreats from this position in Business Electronics. That is, in the dealer termination form of resale price maintenance (the third type quoted in the House Report above), the Court departs from its general approach to horizontal price fixing that any agreement that "interfere[s] with the setting of price by free market forces is illegal on its face,"<sup>171</sup> requiring instead "some agreement on price or price levels."<sup>172</sup> The Business Electronics Court, relying upon GTE Sylvania, rejects the argument that horizontal per se illegality and vertical per se illegality are equivalent, requiring an agreement on price or price levels in the latter, but not the former case. This result is utterly inconsistent with the Court's long-standing and well-reasoned conclusion that horizontal price fixing includes any "tamper[ing] with price structures" and "the machinery employed by a combination for price fixing is immaterial."<sup>173</sup>

Under Business Electronics, "downstream" agreements to maintain specific prices are apparently per se illegal, whereas "upstream" agreements involving efforts by full price retailers to attack their discount competition through a common supplier, are governed by GTE Sylvania's toothless "rule of reason" (virtually, per se legal) standard. As succinctly observed in the House Report accompanying the "Freedom from Vertical Price Fixing Act of 1987," written before the Supreme Court's decision in Business Electronics:

On balance, the renewed focus on the "nature" of the alleged conspiracy (downstream vs. upstream) amounts to little more than an attempt to reverse the per se rule against RPM--which the Supreme Court plainly refused to do when directly confronted with the issue in Monsanto.<sup>174</sup>

By adopting a requirement that illegality requires an agreement on price or price levels in dealer termination cases, the Court adopts another "formalistic distinction" that ignores "economic reality," which, when coupled with its formalistic mischaracterization of dealer termination cases as vertical rather than horizontal, and with the curious burden of proof standard authorized by Monsanto, virtually assures a plaintiff's defeat.

VI. The Sad Legacy of GTE Sylvania--The Demise of § 1 of the Sherman Act

Another, and perhaps most serious, untoward consequence of GTE Sylvania and its progeny is that they threaten to undermine virtually the entire edifice of antitrust law developed under § 1 of the Sherman Act in the last century. Initially, they have dredged up seemingly long discredited cases such as U.S. v. Colgate & Co. (1919)<sup>175</sup> relied

upon in Monsanto<sup>176</sup> and by implication in Business Electronics<sup>177</sup> and U.S. v. General Electric Co. (1926).<sup>178</sup> The renewed vitality of Colgate casts doubt upon the continuing validity of the long line of cases that previously had distinguished and qualified the "Colgate" doctrine virtually out of existence, most notably United States v. Parke Davis (1960)<sup>179</sup> and Albrecht v. Herald Co. (1968),<sup>180</sup> despite the Business Electronics court's attempt to distinguish them.<sup>181</sup> Further, in Business Electronics, the Court resurrected United States v. General Electric whose resale price maintenance scheme, effected through a nominal consignment arrangement, was declared per se illegal by a federal district court in 1973,<sup>182</sup> in reliance on Simpson v. Union Oil Co. (1964)<sup>183</sup> which held that

One who sends a rug or a painting or other work of art to a merchant or a gallery for sale at a minimum price can, of course, hold the consignee to the bargain. . . . When, however, a "consignment" device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the "consignment" an agency, for then the end result of United States v. Socony-Vacuum Oil Co., . . . would be avoided merely by clever manipulation of words, not by differences in substance. The present, coercive "consignment" device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale.<sup>184</sup>

In Business Electronics, Justice Scalia cited General Electric for the proposition that "Dr. Miles does not apply to restrictions on price to be charged by one who is in reality an agent of, not a buyer from, the manufacturer."<sup>185</sup> This casual reference to a case long thought to have been overruled by Simpson, even by Justice Stewart in

dissent in that case,<sup>186</sup> now raises doubt concerning the vitality of Simpson.

In addition, Business Electronics lamely attempts to distinguish General Motors,<sup>187</sup> recognized by the Court in that case as a classic horizontal group boycott. Accordingly, other classic boycott cases may be of questionable current validity.

Further, as Justice Stevens dissent in Business Electronics ably notes "what is most troubling about the majority's opinion is its failure to attach any weight to the value of intrabrand competition."<sup>188</sup> This approach undermines the validity of other cases based on preservation of intrabrand competition, most notably the classic cases in the development of horizontal market division as a per se Sherman Act violation, United States v. Sealy, Inc. (1967),<sup>189</sup> and United States v. Topco Associates, Inc. (1972).<sup>190</sup>

Finally, GTE Sylvania and its progeny have undermined even the most basic Sherman Act premise: the per se illegality of horizontal price fixing. As previously noted, the Court in Business Electronics adopted a price fixing definition for dealer termination cases at odds with that used in other price fixing cases. In addition, the dealer services argument accepted in Business Electronics could be used to justify any price fixing arrangement. As noted by Justice Stevens in dissent in Business Electronics:

[G]iven the majority's total reliance on "economic analysis," . . . it is hard to understand why, if such a purpose [to provide better services] were sufficient to avoid the application of a per se rule in this context, the same purpose should not also be sufficient to trump the per se rule in all other price-fixing cases that arguably permit cartel members to "provide better services."<sup>191</sup>

In sum, perhaps we have already reached the ideal "antitrust" world envisioned by Mr. Bork in which the law "abandon[s] its concern with such beneficial practices as . . . vertical price maintenance and market division."<sup>192</sup> Perhaps we have gone even farther, and have abandoned the law's traditional and legitimate concern with naked horizontal restraints. If so, GTE Sylvania and its progeny have led us there, a result contrary to common sense, the purposes of the Sherman Act, and almost a century of case law based upon real market-place behavior.

## VII. Conclusion

Criticism of Monsanto and Business Electronics has not been confined to judges and legal commentators. Bills are pending in both Houses of Congress<sup>193</sup> to codify the rule of Dr. Miles to declare unequivocally that all forms of resale price maintenance are per se illegal, including conspiracies between a supplier and a distributor to terminate or cut off supply to a second distributor because of the second distributor's pricing policies (the General Motors, Monsanto, and Business Electronics fact patterns). The pending bills also would overrule Monsanto by providing that an inference of concerted action is raised upon proof that the manufacturer terminated or refused to supply goods or services to the plaintiff-dealer "in response to"<sup>194</sup> or "because of,"<sup>195</sup> communications from a competing dealer or dealers regarding price competition by the plaintiff. Under the bills a termination or refusal to supply is "in response to" or "because of" competition communications if such communications are a "major"<sup>196</sup> or

"substantial"<sup>197</sup> contributing cause of the termination or refusal to supply.

Because the Supreme Court has, over the last 12 years, so thoroughly divorced itself from traditional antitrust values in the vertical restraints area, a legislative response is required. The pending statutes, though a step in the right direction, do not go far enough because they do not address the root of the problem: the GTE Sylvania holding.<sup>198</sup> The gross injustice that now characterizes the law governing dealer terminations is based upon an increasingly strained and intentionally confused reading of the GTE Sylvania case. Until GTE Sylvania is confined solely to determining the validity of nonprice restraints in a supplier's distribution process, and a legitimate standard is developed and applied to determine the validity of such restraints, GTE Sylvania will continue to undermine antitrust enforcement under § 1. As noted by Justice Stevens in his dissent in Business Electronics, GTE Sylvania dealt solely with the legality of restrictions imposed by a manufacturer as an integral part of structuring its product distribution system, not with attempts by powerful retailers to structure intrabrand retail competition by coercing manufacturers into cutting off competing retailers.<sup>199</sup>

It is unclear whether, at this point, the GTE Sylvania genie can be put back into its bottle and a searching rule of reason standard developed to judge the limited issue presented by that case. The more important question is whether vertical market division schemes ought to be judged by the rule of reason at all, given the fact that:

- (1) nonprice vertical restraints like vertical price restraints, raise prices and inhibit or eliminate intrabrand competition;<sup>200</sup>
- (2) only plausible or arguable procompetitive justifications support nonprice vertical restraints, which cannot be proven or disproven in any given case;
- (3) no discriminating rule of reason standard has been developed in over 11 years of jurisprudence under GTE Sylvania to judge the legality of nonprice vertical restraints;
- (4) GTE Sylvania has undermined the long-standing prohibition against resale price maintenance in all its forms, not only dealer termination cases such as Monsanto and Business Electronics;
- (5) GTE Sylvania has, through Monsanto and its progeny, led to the resurrection of the formerly closely circumscribed Colgate doctrine and has created needless confusion regarding the fundamental distinction between unilateral and concerted activity, which is at the heart of § 1 enforcement;
- (6) GTE Sylvania has unnecessarily confused the distinction between horizontal and vertical restraints of trade and therefore threatens further to undermine Sherman Act case law governing horizontal restraints of trade;
- (7) GTE Sylvania and its progeny virtually eliminate private enforcement of the Sherman Act for any restraint the arguably can be characterized as vertical, thus providing no protection to retail dealers against coercion, collusion, or exclusionary activities by their competitors and suppliers; and
- (8) a rule of reason approach to nonprice vertical restraints is not necessary to enable suppliers to develop efficient distribution systems.

These consequences clearly indicate that the time has come to overrule GTE Sylvania to restore a rule of per se illegality for all vertical restraints of trade, price and nonprice. Only then will the Sherman Act be restored to its rightful place as the "Magna Carta of free enterprise."<sup>201</sup>



Footnotes

1. 15 U.S.C. § 1. The Sherman Act was enacted in 1890.
2. Id. Violation of § 1 is a felony punishable by imprisonment of up to three years and fines of up to \$100,000 or both for individuals and fines of up to \$1,000,000 for corporations.
3. Clayton Act § 4, 15 U.S.C. § 15. In addition to private treble damage actions, civil equitable actions maintained either by the government or private plaintiffs are a common tool of antitrust enforcement. Section 4 of the Sherman Act (15 U.S.C. § 4) and § 15 of the Clayton Act (15 U.S.C. § 25) confer jurisdiction upon the federal courts to "prevent and restrain" violations and impose a duty upon the Attorney General to institute proceedings in equity for that purpose. Similarly, § 16 of the Clayton Act (15 U.S.C. § 26) authorizes private plaintiffs (such as an injured competitor) to maintain actions to enjoin actual or threatened injury resulting from violation of either the Sherman Act or the Clayton Act.
4. Vertical nonprice restraints include generally some combination of location, territory and customer restrictions. Under a "location" restriction, the seller contractually requires the buyer to resell only from a stated location, such as the buyer's existing retail store. A "territorial" restriction requires a buyer to confine its sales to a given geographic area, such as a city or county or portion thereof. A "customer" restriction

requires, for example, a retailer to sell goods purchased only to consumers and not to other retailers. These restrictions are commonly found in the franchise agreement authorizing the independent dealer to sell the manufacturer's products under the manufacturer's trade name or mark. For example, in White Motor Company v. United States, 372 U.S. 253, 83 S.Ct. 696 (1963), White Motor Company, a manufacturer of trucks and parts, imposed the following territorial and customer restrictions on its franchisees:

Territorial Clause

"Distributor is hereby granted the exclusive right, except as hereinafter provided, to sell during the life of this agreement, in the territory described below, White and Autocar trucks purchased from Company hereunder.

"STATE OF CALIFORNIA: Territory to consist of all of Sonoma County, south of a line starting at the western boundary, or Pacific Coast, passing through the City of Bodega, and extending due east to the east boundary line of Sonoma County, with the exception of the sale of fire truck chassis to the State of California and all political subdivisions thereof.

"Distributor agrees to develop the aforementioned territory to the satisfaction of Company, and not to sell any trucks purchased hereunder except in accordance with this agreement, and not to sell such trucks except to individuals, firms, or corporations having a place of business and/or purchasing headquarters in said territory."

Customer Clause

"Distributor further agrees not to sell nor to authorize his dealers to sell such trucks to any Federal or State government or any department or political subdivision thereof, unless the right to do so is specifically granted by Company in writing."

In United States v. General Motors Corporation, 384 U.S. 127, 86 S.Ct. 1321 (1966), General Motors imposed a location clause on Chevrolet dealers in its dealer selling agreement which prohibited a franchised dealer from moving to or establishing "a new or different location, branch sales office, branch service station, or place of business . . . without the prior written approval of Chevrolet."

5. 221 U.S. 1, 31 S.Ct. 502 (1911).
6. See infra notes 81-100 and accompanying text for a detailed discussion of rule of reason analysis.
7. Northern Pacific Railway Company v. United States, 356 U.S. 1, 5, 78 S.Ct. 514, 518 (1958).
8. For a partial listing of cases establishing horizontal per se violations, see infra notes 54, 55, 57, 59.
9. 220 U.S. 373, 31 S.Ct. 376 (1911).
10. 433 U.S. 36, 97 S.Ct. 2549 (1977).
11. 465 U.S. 752, 104 S.Ct. 1464 (1984).
12. \_\_\_\_ U.S. \_\_\_\_, 108 S.Ct. 1515 (1988).
13. 465 U.S. at 764, 104 S.Ct. at 1471.
14. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1525.

15. See, for example, BORK, THE ANTITRUST PARADOX 288-298 (1978) (hereinafter BORK); Posner, The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality, 48 U. CHI. L. REV. 6 (1981) (hereinafter Posner); Easterbrook, Vertical Arrangements and the Rule of Reason, 53 ANTITRUST L.J. 135 (1984) (hereinafter Easterbrook).
16. 372 U.S. 253, 83 S.Ct. 696 (1963).
17. 388 U.S. 365, 87 S.Ct. 1856 (1967).
18. 433 U.S. 36, 97 S.Ct. 2549 (1977).
19. The Supreme Court in United States v. Topco Associates, Inc., 405 U.S. 596, 92 S.Ct. 1126 (1972), stated:

It is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act. . . . One of the classic examples of a per se violation of § 1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition. . . . This Court has reiterated time and time again that "[h]orizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition." White Motor Co. v. United States, 372 U.S. 253, 263, 83 S.Ct. 696, 702, 9 L.Ed. 2d 738 (1963). Such limitations are per se violations of the Sherman Act. (405 U.S. at 607-608, 92 S.Ct. at 1133-1134.)

The court went on to hold that horizontal market division is per se illegal whether or not accompanied by other antitrust violations (405 U.S. at 609 n. 9, 92 S.Ct., at 1134 n. 9).

Note that Topco, like White Motor and other vertical restraint cases discussed in this paper, involved intrabrand market division. Topco was recently cited with approval by the Supreme Court in Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_\_ U.S. \_\_\_\_, \_\_\_\_, 108 S.Ct. 1515, 1524 (1988).

20. 372 U.S. at 261, 83 S.Ct. at 701. (Emphasis in original.)
21. 372 U.S. at 276, 83 S.Ct. at 708 (Clark, J., dissenting).
22. 372 U.S. at 278, 83 S.Ct. at 709 (Clark, J., dissenting).
23. 372 U.S. at 279, 281, 83 S.Ct. at 710-711 (Clark, J., dissenting).
24. 388 U.S. at 378-380, 87 S.Ct. at 1865-1866.
25. For a sampler of criticism of Schwinn, see Justice Stewart's dissent in Schwinn, 388 U.S. at 382-394, 87 S.Ct. at 1867-1873; BORK, supra note 15 at 282-285 (1978); Handler, The Twentieth Annual Antitrust Review--1967, 53 VA. L. REV. 1667, 1680-89; Pollock, Alternative Distribution Methods After Schwinn, 63 NW. L. REV. 595 (1968); Sadd, Territorial and Customer Restrictions After Sealy and Schwinn, 38 U. CIN. L. REV. 249 (1969); The Supreme Court, 1966 Term, 81 HARV. L. REV. 69, 235-39 (1967); Note, Restrictive Distribution Agreements After the Schwinn Case, 53 CORN. L. REV. 515 (1967). Note, Territorial and Customer Restrictions: a Trend Toward a Broader Rule of Reason?, 40 GEO. WASH. L. REV. 123 (1971). For a more inclusive

list of articles and comments, see GTE Sylvania, Incorporated v. Continental T.V., Inc., 537 F.2d 980, 988 n. 13 (1976).

26. 377 U.S. 13, 84 S.Ct. 1051 (1964).
27. See SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 404-406 (1977).
28. 537 F.2d 980 (9th Cir. 1976).
29. 433 U.S. at 51-52, 54-55, 97 S.Ct. at 2558, 2560.
30. 433 U.S. at 57-59, 97 S.Ct. at 2561-2562.
31. As Professor Sullivan has noted:

In distribution, as in other aspects of the productive process, rivalry between traders tends to keep prices down and to stimulate efforts to reduce costs while increasing quality, service and shopping convenience. Furthermore, since the ability of a trader to offer (or approach) that mixture of high quality, low price, efficient service and attractive, convenient facilities which the public regards as optimal is what maximizes the trader's reward in a competitive distribution market, competition in distribution (as in production) stimulates a response which the public values highly. The Supreme Court has consistently pointed to these goals as basic ones for antitrust policy.

But low prices and optimum allocation are not the only public interests which competition fosters; it also tends toward other important social values: economic stability, fair and rational income distribution, an economic climate in which any person can aspire to independence and growth, dispersion of political and social as well as economic power, and fair and objective decisions dictated by market forces in economic relations between individuals. These values too are relevant to the development of a sound antitrust policy with respect to the distribution sector. Sound public policy thus requires that the decision whether a particular retail trader is to sell in a particular market should be a personal

decision based upon a personal readiness to take the risks and suffer the consequences; it should not be an administered decision made for the trader by the home office personnel of a national manufacturer. Any argument against per se treatment of territorial or customer resale restraints must then be based on the existence of offsetting advantages which, at least in some instances, may be more beneficial than damaging to competition. (SULLIVAN, supra note 27 at 411-412.)

32. Id. at 413.

33. Id.

34. Id. at 414.

35. U.S. DEPARTMENT OF JUSTICE, VERTICAL RESTRAINTS GUIDELINES § 3.1 (Jan. 23, 1985).

36. SULLIVAN, supra note 27 at 414.

37. THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, VERTICAL RESTRAINTS GUIDELINES § 3.2 (Dec. 4, 1985). In the context of fair trade, former President Ronald Reagan once noted:

[I]n an age when advertising has effectively pre-sold so many brand names, is the retailer really providing any extra useful service to the consumer in exchange for that higher margin? It's nice to know that he carries a broad selection, but without fair trade, wouldn't an enterprising merchant carry as broad a line of, say cosmetics as his customers demand? (From a column written by Mr. Reagan for Copley News Service, reprinted at 121 Cong. Rec. 1268 (Jan. 23, 1975).)

38. For example, Stephen J. Jelin, president of Prange Way Stores, speaking on behalf of the National Mass Retailing Institute recently noted:

From my perspective, I seriously doubt the validity of the free-rider theory. The literature of which I am aware, and my own hands-on experience, tell me that consumers rarely, if ever, take advantage of the services of one outlet and then purchase the product elsewhere; and I know that to be true because my company operates full-service department stores that are adjacent to, and in many cases, even share premises with our discount stores, both carrying the same identical merchandise. Customers usually buy products, even sophisticated computer products, at the stores where they received the initial demonstration. Further, price competition and good service can, and do, go hand-in-hand in most cases. For years discount retailers have been selling complex products. Our stores, for example, carry a substantial line of consumer electronics, a limited selection of personal computers, a fair choice of telephonic equipment, a lot of diverse small appliances, an impressive array of cameras and sight and sound equipment, and a lot of other such merchandise that requires technical knowledge on the part of the purchasing consumer. We provide what technical data and information we can, within the constraints that a no-frills, self-service, low-margin operation imposes, primarily in the form of clearly presented manufacturer-supplied information; and we back our commitment to our customer with a "satisfaction guaranteed, no questions asked refund policy." We are hardly "free-riders"; and we sell a great deal of merchandise to a large number of satisfied customers who want to shop for both items and prices.

The whole "free-rider" concept is particularly troublesome to me, with my personal background in apparel retailing, when I find it being used as a kind of intellectual stretcher-bar to extend the notion of permissible price restraints to cover apparel and health and beauty aids and candy, and all sorts of categories to which it is patently not a bit relevant... and equally patently anti-competitive in its effect.

The consumer is the best judge of whether she or he wishes to pay more for more technical consultation and expertise with her product, or less without it. And I assure you that the consumer's choices resonate loudly and clearly in the free marketplace. Most discounters have gone out of the expensive personal computer business because most



customers for that commodity made it clear that they would prefer to pay more elsewhere. However, other sophisticated electronics businesses, like television sets and microwave ovens, are appropriately carried by both discount and non-discount outlets and an unproven and questionable theory like "free-rider" should not be intruded into this free market system by an executive agency. (Senate Hearing, infra note 40 at 118-119.)

39. Comanor, Vertical Price Fixing, Vertical Market Restrictions, and the New Antitrust Policy, 98 HARV. L.R. 983, 987-988 (1985).
40. Statement of Lawrence A. Sullivan, Statement Concerning the Department of Justice Vertical Restraint Guidelines: Hearings Before Senate Committee on the Judiciary, S. Hrg. 99-224 (July 16, 1985) at 72.
41. Id. at 72-73.
42. For example, in a recent letter to the editor of the National Law Journal, Gary J. Shapiro, Staff Vice President of the Consumer Electronics Group of the Electronic Industries Association, in support of the Supreme Court's GTE Sylvania and Business Electronics decisions stated:

The antitrust views of the Supreme Court have furthered consumer welfare. Ironically, both decisions involved sales of consumer electronics products (televisions and calculators, respectively). Since the GTE Sylvania decision, color TV prices have dropped more than 10 percent; other consumer electronics products experienced similar price drops. (National Law Journal, October 24, 1988 at 12.)
43. Senator Strom Thurmond recently stated, in opposing a bill that would overrule Monsanto and codify the per se prohibition against

resale price maintenance, that the discount industry has flourished even after Monsanto was decided. See, S. Rep. 100-280, 100th Cong., 2d Sess. 16-17 (1988) (minority views of Senators Thurmond, Hatch, and Simpson).

44. For example in Sylvania, the manufacturer increased its market share after its vertical restraints were instituted without evidence of profitability.
45. SULLIVAN, supra note 27 at 417.
46. Id.
47. See, supra note 42.
48. GTE Sylvania Incorporated v. Continental T.V. Inc., 537 F.2d 980, 1026 n. 16 (9th Cir. 1976) (Browning, J., dissenting).
49. Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_\_ U.S. \_\_\_\_, \_\_\_\_, 108 S.Ct. 1515, 1520 (1988).
50. GTE Sylvania Incorporated v. Continental T.V. Inc., 537 F.2d 980, 1028-1029 (9th Cir. 1976) (Browning, J., dissenting).
51. Id at. 1028.
52. SULLIVAN, supra note 27 at 419.
53. Standard Oil Co. v. United States, 221 U.S. 1, 31 S.Ct. 502, 515-516 (1911).

54. Northern Pacific Railway Company v. United States, 356 U.S. 1, 5, 78 S.Ct. 514, 518 (1958).
55. United States v. Socony-Vacuum Oil Co., Inc., 310 U.S. 150, 60 S.Ct. 811 (1940).
56. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 31 S.Ct. 376 (1911).
57. Fashion Originators Guild v. FTC, 312 U.S. 457, 61 S.Ct. 703 (1941).
58. Northern Pacific Railway Company v. United States, 356 U.S. 1, 78 S.Ct. 514 (1958).
59. United States v. Topco Associates, Inc., 405 U.S. 596, 92 S.Ct. 1126 (1972).
60. Areeda, The "Rule of Reason in Antitrust Analysis: General Issues 2 (Federal Judicial Center (1981)); see also, 6 AREEDA, ANTITRUST LAW 371 (1986).
61. Id. at 16-17.
62. 6 AREEDA, ANTITRUST LAW 371-372 (1986).
63. 374 U.S. 321, 83 S.Ct. 1715 (1963).
64. Id., 374 U.S. at 370, 83 S.Ct. at 1745.
65. 405 U.S. 596, 92 S.Ct. 1126 (1972).

66. 405 U.S. at 609-611, 92 S.Ct. at 1134-1135.
67. 405 U.S. at 609-610, 92 S.Ct. at 1134 (emphasis added).
68. See BORK, supra note 15; Bork, Legislative Intent and the Policy of the Sherman Act, 9 J. L. & ECON. 7 (1966); POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 23 (1976); Posner, The Chicago School of Antitrust Analysis, 127 U. PA. L. REV. 925 (1979). For a brief introduction to the views of the Chicago School, see Cann, infra note 71, at 486-493.
69. Lande, An Anti-Antitrust Activist, NAT'L L.J., Sept. 7, 1987 at 28 (hereinafter "Lande II"); Lande, Wealth Transfers and the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged, 34 HASTINGS L.J. 65, 68 (1982) (hereinafter "Lande I").
70. As noted by Professor Sullivan:

Among the non-economic goals of antitrust, all quite tenable as policy objectives, are a preference for decentralization of economic power, reduction of the range within which private discretion may be exercised in matters materially affecting the welfare of others, enhancement of the opportunity for more people to exercise independently entrepreneurial impulses, and, most blatantly, a social preference for the small rather than the large. (SULLIVAN, supra note 27 at 11.)

Professor Hovenkamp summarizes noneconomic "competing" values as including

maximization of consumer wealth, protection of small businesses from larger competitors, protection of easy entry into business, concern about large accumulations of economic or political power,

prevention of the impersonality or 'facelessness' of giant corporations, encouragement of morality or 'fairness' in business practice, and perhaps some others." HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW 41-42 (1985).

71. Cann, Vertical Restraints and the "Efficiency" Influence--Does Any Room Remain For More Traditional Antitrust Values and More Innovative Antitrust Policies?, 24 A.B.L.J. 483, 484 (1987).
72. Id.; see Posner, supra note 15.
73. Professor Cann advocates a more rigorous rule of reason analysis than that espoused by the Chicago School in judging the legality of vertical restraints:

Antitrust policy should balance the goals of Congress, the needs of consumers, and the requirements of changing industries more appropriately than does the currently fashionable Chicago efficiency approach. Although the pursuit of efficiency is a laudable goal, the elevation of efficiency to the pinnacle of antitrust values has largely been the consequence of the visions (or biases) of the caretakers of antitrust enforcement. Contrary to the beliefs of the Chicago economist, however, the status that should be accorded efficiencies within the broader pecking order of social values remains an open question. The value of efficiencies should be weighed against the values that can be derived from product accessibility, consumer convenience, promotional diversification, intrabrand dealer selection, entrepreneurial innovation, entry and exit capabilities, and the diffusion of economic decision-making. (Cann, supra note 71 at 538.)

The National Association of Attorneys General, Vertical Restraints Guidelines (Dec. 4, 1985) also advocate a searching rule of reason analysis noting:

In weighing the interbrand effects of a non-price vertical restraint of trade, which may be anticompetitive, or pro-competitive and counter-balance or outweigh the anticompetitive intrabrand effects, the following factors will be assessed:

1. The extent of product differentiation (relative elasticity of demand, possibility of intrabrand free-riding) or fungibility (highly elastic demand, possibility of interbrand free-riding and increased probability of collusion);
2. Whether restraints have resulted in multi-brand exclusive distributors (reduced interbrand competition and facilitation of collusion when congruent and inefficiency when non-congruent);
3. The extent to which a restraint is adopted as a result of dealer pressure;
4. Whether a supplier requires that additional services be performed by dealers subject to a restraint and monitors compliance and whether additional services have been rendered subsequent to imposition of the restraint (evidence of pro-competitive intent and effect);
5. The contractual longevity and rigidity of a restraint (potentially maintaining an anticompetitive restraint) and its natural longevity (demonstrating its actual efficiency);
6. The effect the restraint has upon the realization of scale economies;
7. Concentration and coverage of the markets where the restraint is imposed (facilitation of interbrand collusion and exclusion of rivals);
8. Whether the industry where the restraint is imposed is oligopolistic in nature and whether patterns of tacitly collusive or consciously parallel behavior exist;
9. The output performance of individual firms and the industry after the restraint was imposed (output increase as a result of new demand is generally efficient), (output increase as a result of "cannibalizing" existing demand is either inefficient or ambiguous);
10. Whether the restraint eases entry (pro-competitive) or raises entry barriers (anticompetitive) and whether entry barriers unrelated to the restraint are high or low (predicting how quickly an anticompetitive restraint would result in new entrants);
11. Whether the number of price/quality options for consumers are increased (pro-competitive) or decreased (anti-competitive) by imposition of the restraint; and

12. Miscellaneous factors such as the regulatory climate, history of collusive practices and the actual competitive intent of firms imposing a restraint. (Id. at § 4.16.)

74. See, Easterbrook, supra note 15; Posner, supra note 15.
75. Id.
76. For a discussion of some of these cases, see Cann, supra note 71 at 505-509.
77. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 1024 (1976) (Browning, J., dissenting). And as noted by the Supreme Court in United States v. Topco Associates, Inc., 405 U.S. 596, 609-610, 92 S.Ct. 1126, 1134 (1972):
- The fact is that courts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another is one important reason we have formulated per se rules.
78. See supra note 48 and accompanying text; see also, Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 LAW & CONTEMP. PROB. 506, 508-509 (1965).
79. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 1024, 1026-1027 (1976) (Browning, J., dissenting).
80. United States v. Topco Associates, Inc., 405 U.S. 596, 611-612, 92 S.Ct. 1126, 1135 (1972).

81. See, Cann, supra note 71 at 505-509. Professor Cann also notes:

[V]ertical restraints inherently restrain intrabrand competition. They tend to decrease the number of available dealers, they tend to reduce product accessibility, and they have the potential for creating higher prices for infra-marginal purchasers. They tend to frustrate retailer innovation and concentrate both economic and decision-making power in the hands of fewer individuals. They tend to create barriers to entry (whether categorized as natural or artificial), they tend to delay the effects of corrective market forces, they tend to reduce the range of consumer options, and they appear to place primary emphasis on stimulating demand (and the higher prices that can result) rather than on increasing the capacity for supply. (Id. at 535.)

82. Statement of Lawrence A. Sullivan, supra note 40 at 67.

83. Id. at 78.

84. When most or all of the competing suppliers in a concentrated industry limit the number and geographical reach of their dealers, a dealer's cartel will be shielded from competitive prices from outside the cartel's region. Similarly, direct collusion among suppliers or collusion with dealers acting as surrogates is facilitated. Furthermore, the widespread use of such restraints facilitates the policing of a conspiracy, by strictly controlling the number of outlets that must be monitored for compliance. (NAAG Guidelines, supra note 37 at § 3.3B; see also, Justice Department Guidelines, supra note 35 at § 3.21.)

85. When the dominant firms in a concentrated market bind available dealers to exclusive dealing arrangements, rivals of the dominant firms or potential entrants may have difficulty arranging for the distribution of their products. Potential entrants may be forced to enter the market at two levels rather than one, making entry significantly more costly. Existing competitors may be forced to vertically integrate or find new independent dealers. Either option may be more costly than distributing through the now foreclosed dealers.



A firm may contract for the exclusive right to purchase an important component in the manufacturing or distribution process. If the exclusive arrangement leaves insufficient quantities of the important component for competitors, potential or existing, entry barriers may be raised and costs of production increased. This will occur if the competing firms must integrate into the production of the component, and this is more costly, or if they are forced to substitute a less cost-effective or suitable component. (NAAG Guidelines, supra note 37 at § 3.3C; see also Justice Department Guidelines, supra note 35 at § 3.22.

86. NAAG Guidelines, supra note 37 at § 3.3D.
87. Comanor, Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath, 81 HARV. L.R. 1419, 1437 (1968); Zimmerman, Distribution Restrictions After Sealy and Schwinn, 12 ANTITRUST BULL. 1181, 1183-1185 (1967); Schmitt, Antitrust and Distribution Problems in Tight Oligopolies--A Case Study of the Automobile Industry, 24 HASTINGS L.J. 849, 906 (1973).
88. Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 YALE L.J. 373 (1966); Bork, A Reply to Professors Gould and Yamey, 76 YALE L.J. 731 (1967).
89. See Comanor, Vertical Price Fixing, Vertical Market Restrictions, and the New Antitrust Policy, 98 HARV. L.R. 983 (1985). For example, Professor Comanor notes:

The conventional wisdom fails to acknowledge the importance of differences among consumers regarding their preferences for dealer-provided services. Where such differences exist, manufacturers' and consumers' interests do not necessarily coincide. (Id. at 990.)

And as Professor Sullivan explained:

It is true that some same-brand restraints can in some circumstances have some affirmative effects on interbrand competition. For example, primary responsibility clauses, location clauses, or passover arrangements might be used by a new entrant or a weak brand to encourage point of sale promotion or service. But even when a benefit of that kind is present, there is also a cost. The restraint is intended to reduce intrabrand competition, thus enabling the dealer to charge a higher price. The notion is that interbrand competition will preclude the dealer from pocketing a monopoly return; he will be forced by interbrand competition to spend the extra return on promotion or service. The welfare of consumers who would not otherwise have known about the product, or who had need for the additional service, will thus be increased. But the cost is there too. All consumers pay the new, higher price that the restraint supports, including those that knew about the product even before the restraint, and those who do not need the additional service. . . .

[I]t is more important to recognize that even when the restraint enhances the return to the manufacturer, that does not mean that the manufacturer is distributing the product in the way that is "best" for consumers. Manufacturer welfare is not a reliable surrogate for consumer welfare. Some Chicago theorists, like Bowman, have recognized this. Others, like Posner and Bork, have not. . . . [A] vertical restraint always hurts those consumers who do not need (and would, if given the choice, not have paid for) the additional information, additional service or additional amenity supported by the higher prices facilitated by the restraint. The restraint is a benefit only to those consumers who, if given the choice, would have preferred to pay the higher price in order to receive the additional service, information or amenity. Indeed, the restraint benefits these consumers only if, but for the restraint, no dealer would have offered the higher price, higher service, information, or amenity option. If the market would have given a reasonable range of such options even without the restraint, there are consumers whose welfare is impaired, but none whose welfare is improved.

In sum, the manufacturer may choose the method of distribution best for him, but not best for consumers. (Statement of Lawrence A. Sullivan, supra note 40 at 78-79.)

90. Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560, 1573 (11th Cir. 1983). This approach, which shifts the burden of persuasion to the defendant to justify restraints crossing a certain anticompetitive threshold has been advocated by Professor Areeda (see supra note 62 and accompanying text) and by Professor Cann, who notes:

By requiring manufacturers to prove such countervailing benefits in connection with restraints that cross a given threshold, antitrust officials could ensure that vertical activities that result in substantial adverse intrabrand and social effects will be undertaken with at least some worthwhile purpose in mind. When a manufacturer is unable to demonstrate any reasonable likelihood of counterbalancing benefits, the argument that the purpose of the restraint is to enhance the manufacturer's interbrand competitive position (rather than merely to isolate retailers from intrabrand competition) loses credibility. Under such circumstances, little harm would result from a decision prohibiting the restraint. . .

While no formal mechanisms have been established for shifting the burden of proof in cases involving restraints of substantial proportion, there is support for the proposition that firms imposing vertical restraints should be required more clearly to justify their actions. In Eiberger v. Sony Corp. of America, 622 F.2d 1068 (2d Cir. 1980), for example, the court indicated that in those cases where no interbrand benefit can be established, an adverse impact on intrabrand competition may by itself support a finding of antitrust violation. Id. at 1075, 1081. In Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560 (11th Cir. 1983), the court recognized that an antitrust plaintiff must not be required to disprove all conceivable procompetitive justifications in order to demonstrate a violation of the antitrust laws. Id. at 1573. The NAAG Guidelines, reflecting the position of the fifty

state attorneys general, specifically recognize that the potential benefits of vertical restrictions should not be presumed. NAAG Guidelines, . . . at § 3.2. Their likely benefits must be demonstrated. Id. The adoption of a threshold beyond which procompetitive justifications or counterbalancing benefits would have to be demonstrated, would represent an explicit recognition of the concerns expressed in the NAAG Guidelines and by the courts in such cases as Eiberger and Itek. (Cann, supra note 71 at 536.)

As noted above, proof of the existence of the restraint should be the appropriate threshold which shifts the burden of persuasion.

91. The Justice Department's Vertical Restraints Guidelines, supra note 35, prompted a hearing by the Senate Judiciary Committee, S. Hrg. 99-224 (July 16, 1985), in which the guidelines were roundly denounced. Further, Congress passed a joint resolution, P.L. 99-180, 99 Stat. 1169, which was signed into law by President Reagan on December 13, 1986, which states, inter alia, that the Justice Department Vertical Restraint Guidelines "do not have the force of law, do not accurately state current antitrust law, and should not be considered by the courts of the United States as binding or persuasive." Note that the NAAG Guidelines, supra note 37, were written in response to and as a repudiation of the Justice Department Guidelines.
92. Justice Department Guidelines, supra note 35 at § 4.226. See also In re Beltone Electronics Corp., 100 F.T.C. 68, 209 (1982).
93. Statement of Lawrence A. Sullivan, supra note 40 at 77.

94. Easterbrook, supra note 15 at 145, 151.
95. United States v. Colgate & Co., 250 U.S. 300, 307, 39 S.Ct. 465, 468 (1919); Monsanto Company v. Spray-Rite Service Corporation, 465 U.S. 752, 760, 104 S.Ct. 1464, 1469 (1984).
96. SULLIVAN, supra note 27 at 423-424.
97. Professor Sullivan notes that

The arrangements have been upheld when [1] the manufacturer is introducing a new product and where significant capital investment must be made or substantial expense incurred by the dealer, or [2] when the seller is a small or weak firm in its market. (Id. at 424.)

For the first proposition, he cites United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 64 S.Ct. 805 (1944); and for the second, Schwing Motor Co. v. Hudson Sales Corp., 138 F.Supp. 899 (D.Md.), aff'd, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823, 78 S.Ct. 30, 38 (1957); Packard Motor Car Co. v. Webster Motor Car Co., 100 U.S. App.D.C. 161, 243 F.2d 418 (D.C.Cir.), cert. denied, 355 U.S. 822, 78 S.Ct. 29 (1957); Hevermon, Dealer Territorial Security and "Bootlegging" in the Auto Industry, 1962 WIS.L.REV. 486; Kessler, Automobile Dealer Franchises: Vertical Integration by Contract, 66 YALE L.J. 1135 (1957); PASHIGIAN, THE DISTRIBUTION OF AUTOMOBILES: AN ECONOMIC ANALYSIS OF THE FRANCHISE SYSTEM (1961); Rifkind, "Division of Territories," in HOW TO COMPLY WITH THE ANTITRUST LAWS (Van Cise & Dunn, eds. 1954).

98. As noted by Professor Sullivan:

[E]xclusive dealerships, unlike territorial or location restrictions on dealers, cannot be used to stamp out intrabrand competition entirely. If the authorized dealer sets prices too high, or provides inadequate service, promotes inefficiently or otherwise creates market opportunities, a dealer authorized and receiving shipments elsewhere can ship goods into the exclusive area and sell them there. . . . To allow the manufacturer to use [an exclusive dealership] system is, in effect, to concede to the manufacturer a legitimate interest in how its goods are handled on resale, while not allowing it to press that interest to an extreme. The distinction between a seller's promise and a buyer's is perhaps a practical, if clumsy, place to draw the line. Moreover, the seller's promise, being less restrictive than the buyer's, can be defended as the less restrictive way of achieving manufacturer objectives. In addition, the exclusive franchise differs from the territorial restriction on the buyer in that the latter is often charged with a coercive energy which is likely to be lacking where the only restriction is upon the seller. (SULLIVAN, supra note 27 at 424, 426-427.)

The House report accompanying the "Freedom from Vertical Price Fixing Act of 1987" addresses the less restrictive alternatives issue in the context of resale price maintenance:

The Justice Department has . . . argued that resale price maintenance is procompetitive because it is a useful tool for expanding a manufacturer's dealer network or encouraging dealers to provide additional promotion or services. To be sure, a guaranteed higher minimum retail price can be an incentive to a retailer considering whether to handle a product. But however useful to suppliers or some retailers, a minimum resale price hurts consumers. And manufacturers have other means to achieve these ends that will not harm consumers.

A manufacturer may offer numerous enticements to a potential new dealer, including attractive prices, funds to subsidize dealer promotions, and even an exclusive dealership. In addition, manufacturers who wish dealers to provide advertising or services commonly contract separately with their dealers to provide such services. The "free rider" problem--that discounters may rely on full-price

dealers to provide advertising, information, and warranty services--can be addressed most effectively through such contractual commitments, without the harm to consumers that ensues from such vertical price fixing. Indeed, absent a contractual commitment, resale price maintenance would, in any event, not eliminate free riders since full price retailers could still disregard dealer service and promotion standards. (H.R. Rep. No. 100-421, 100th Cong., 1st Sess. 13 (1987) (hereinafter "House Report").

It may be argued that a location clause is necessary to enforce an exclusive distributorship; that is, the manufacturer could not keep its promise to license only one dealer in a given area if dealers licensed in other territories were free to open new stores outside their geographic area. In fact, a location clause is not necessary. If a dealer is both efficient enough to adequately develop and serve its territory and has the capital and ability to expand into another area, why not let it? The possibility that a dealer initially licensed in one territory might later expand to another or others should provide an incentive for all dealers to be efficient and over time lessens the intrabrand insulation of the exclusive distributorship.

99. 6 AREEDA, ANTITRUST LAW ¶ 1508 (1986).
100. Williams, Distribution and the Sherman Act--The Effects of General Motors, Schwinn and Sealy, 1967 DUKE L.J. 732, 735. See also Zimmerman, supra note 87, at 1186-87 & n.8.
101. For example, Professor Easterbrook reads GTE Sylvania to provide "a highly deferential standard of review" under which vertical

restraints "are lawful except in the rarest of cases."

Easterbrook, supra note 15 at 135.

102. 465 U.S. 752, 104 S.Ct. 1464 (1984).
103. \_\_\_\_ U.S. \_\_\_\_, 108 S.Ct. 1515 (1988).
104. SULLIVAN, supra note 27 at 427.
105. 465 U.S. at 756, 104 S.Ct. at 1466-1467.
106. 684 F.2d 1226 (7th Cir. 1982).
107. Id. at 1238.
108. 465 U.S. at 761, 104 S.Ct. at 1469.
109. 465 U.S. at 762-764, 104 S.Ct. at 1470-1471.
110. SULLIVAN, supra note 27 at 427.
111. House Report, supra note 98 at 14.
112. Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_\_ U.S. \_\_\_\_, \_\_\_\_, 108 S.Ct. 1515, 1526 (1988)  
(Stevens, J., dissenting).
113. 384 U.S. 127, 86 S.Ct. 1321 (1966).
114. As noted by the Court:

There is evidence that unanimity was not obtained without reference to the ultimate power of General Motors. The testimony of dealer Wilbur Newman was that regional manager Cash related a



story, the relevance of which was not lost upon him, that in handling children, "I can tell them to stop something. If they don't do it \* \* \* I can knock their teeth down their throats." 384 U.S. at 136, 86 S.Ct. at 1326.

115. 384 U.S. at 138, 86 S.Ct. at 1326-1327.
116. 384 U.S. at 139-140, 143, 145, 86 S.Ct. at 1327-1330.
117. The Court discussed Klor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 79 S.Ct. 705 (1959) and cited Fashion Originators' Guild of America, Inc. v. Federal Trade Comm'n, 312 U.S. 457, 61 S.Ct. 703 (1941), and Eastern States Retail Lumber Dealers' Assn. v. United States, 234 U.S. 600, 613-614, 34 S.Ct. 951, 954-955 (1914), neither of which involved price-fixing.
118. 384 U.S. at 146, 86 S.Ct. at 1331.
119. 384 U.S. at 147-148, 86 S.Ct. at 1331-1332.
120. 384 U.S. at 140, 86 S.Ct. at 1327. In commenting on the dealer termination cases and specifically General Motors, Professor Sullivan noted:

When the manufacturer sets up a dealership structure and binds itself not to add dealers in any existing territory, we truly have a vertical restraint. But when an existing dealer enlists the manufacturer to choke off one of the dealer's competitors, although the "agreement" which enables Section 1 to be invoked is vertical, the restraint thereby achieved is horizontal in its impact; it is an attack by one dealer against another. . . . In General Motors, where several dealers concertedly induced the manufacturer to hamper the aggressive selling efforts of a competitor, the Court dismissed out of hand the sug-

gestion that it faced a vertical problem, one that resonated with exclusive franchise arrangements. The Court saw the matter for what it was, a "classic conspiracy" to drive out competition. (SULLIVAN, supra note 27 at 429.)

In Business Electronics, a case involving only one complaining full price dealer, Justice Stevens agreed that the horizontal boycott analysis used in General Motors should govern the case:

When a manufacturer responds to coercion from a dealer, instead of making an independent decision to enforce a predetermined distribution policy, the anticompetitive character of the response is evident. As Professor Areeda has correctly noted, the fact that the agreement is between only one complaining dealer and the manufacturer does not prevent it from imposing a "horizontal" restraint. If two critical facts are present--a naked purpose to eliminate price competition as such and coercion of the manufacturer--the conflict with antitrust policy is manifest.

Indeed, since the economic consequences of Hartwell's ultimatum to respondent are identical to those that would result from a comparable ultimatum by two of three dealers in a market--and since a two-party price-fixing agreement is just as unlawful as a three-party price-fixing agreement--it is appropriate to employ the term "boycott" to characterize this agreement. In my judgment the case is therefore controlled by our decision in United States v. General Motors Corp., 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966). (Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_ U.S. \_\_\_, \_\_\_ - \_\_\_, 108 S.Ct. 1515, 1530-1532 (1988) (Stevens, J., dissenting).)

121. Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_ U.S. \_\_\_, \_\_\_, 108 S.Ct. 1515, 1521 (1988).
122. Id., \_\_\_ U.S. at \_\_\_, 108 S.Ct. at 1520. See also, Continental T.V., Inc. v. GTE Sylvania, Incorporated, 433 U.S. 36, 58-59, 97 S.Ct. 2549, 2562 (1977).

123. See supra notes 90-94 and accompanying text.
124. A brief examination of the Chicago School's reaction to Monsanto further illustrates the bankruptcy of the Chicago School approach. Professor Easterbrook praises the Monsanto court for "recognizing" the value of restricted dealing and asserts that the Court's opinion calls the Dr. Miles rule of per se illegality for resale price maintenance into doubt, but expressed the following reservation:

I do not want to leave the impression of unre-served joy about this opinion. The Court affirmed the judgment against Monsanto by pointing to some evidence from which the jury could have inferred actual RPM agreements among Monsanto and some nonterminated dealers. The sort of evidence to which the Court pointed is common in complex systems of distribution. Monsanto had more than 100 dealers and many field personnel. It would be surprising indeed if a search of Monsanto's, or any other manufacturer's, files did not turn up some documents that could be read as expressing "agreement" on price. If one or two such documents are enough to go to a jury, then the manufacturer does not have the breathing space the Court intended to provide for the discussions of price and service that the justices recognized as legitimate. The cost of trial, and the risk of erratic judgments, will deter manufacturers from using the practices the Court calls beneficial. (Easterbrook, supra note 15 at 171-172.)

Contrary to Professor Easterbrook's assertion, the evidence of conspiracy in Monsanto involved far more than "one or two" ambiguous documents that "could be read as expressing 'agreement' on price." In any event the trier of fact, who hears the witnesses, and has seen the documentary evidence, should certainly be capable of distinguishing legitimate business

communication from evidence of a conspiracy to drive a competitor out of business. Professor Easterbrook further talks of "breathing space" for manufacturers for legitimate discussions of price and service, and laments that the dealer recovery in Monsanto will "deter manufacturers from using the practices the court calls beneficial." In the first place, the Court has never said vertical restraints are beneficial. They are restraints of trade governed by rule of reason rather than per se analysis because the Court has accepted the controversial proposition that they may benefit interbrand competition, even though they obviously restrict intrabrand competition.

Secondly, the legality of Monsanto's distribution system was not in issue here. In this case, as Professor Sullivan, the Court in General Motors, and Justice Stevens in his Business Electronics dissent, have astutely observed, the issue is not whether and to what extent a supplier can restrict prospective intrabrand competition among retailers; the issue is whether the law ought to permit a competitor or group of competitors to enlist a supplier in a concerted effort to drive a price cutting competitor out of business. In this context, bleatings regarding protection of "legitimate" price and service discussions concerning use of "beneficial" practices ring particularly hollow.

Professor Easterbrook also criticized the remedy determination in Monsanto noting:

There is also a question of remedy. Why does the existence of a RPM agreement between Monsanto and Dealer #1 give Spray-Rite (Dealer #101) a right to lost profit damages? The Court treated the case as if every one of Monsanto's dealers acquired tenure when Monsanto struck an illegal agreement with one dealer. The RPM agreement with Dealer #1 might hurt consumers of Monsanto's products, but what concern is this of Spray-Rite? Is it that Spray-Rite has a right not to be fired for attempting to undermine the RPM agreement with Dealer #1? Certainly the terminated dealer should be required to have proof to that effect, but why is it enough? It would be legitimate to fire a dealer for attempting to undermine the sort of tacit understanding with Dealer #1 that Colgate supports, so why is firing to protect RPM different? And why is Spray-Rite's lost profit the proper measure of damages, when antitrust is designed to protect competition rather than competitors?

These questions of causation and damages lurk in every dealership termination case. No one briefed these issues in Monsanto, and the Court cannot be faulted for passing them by. They await attention by the lower courts, and they offer further opportunities to reduce the scope of the Dr. Miles rule in the common law fashion. (Easterbrook, supra note 15 at 172.)

The tone of Professor Easterbrook's criticism is instructive. He fails to see why Monsanto's agreement with its other distributors should be of any concern to Spray-Rite. Simply stated, the conspiracy destroyed Spray-Rite's business. Under Professor Easterbrook's view, it is clear that Spray-Rite should have no recovery on these facts. He once again mouths the words that "antitrust is designed to protect competition rather than competitors" (see infra note 145); but how does his view of the case protect competition in any meaningful sense? Spray-Rite's actual and potential customers will now have to pay more for their herbicides. Spray-Rite, a vigorous price competitor, was

driven from the business through a wholly successful combination explicitly designed to stifle price competition. The end result is clear: fewer choices and higher prices for consumers.

Professor Easterbrook takes solace in the fact that the causation and damages questions in dealership termination cases will provide courts with further opportunities to reduce the scope of the Dr. Miles rule. This approach would apparently eliminate any judicial scrutiny of any vertical restraint (price or nonprice) or of any combination to enforce such a restraint, no matter how coercive. Such an approach sanctions wholesale boycott behavior by established competitors, all openly policed by a common supplier, all under the rubric of "unilateral action" and "vertical activity." Once again, it is time to recognize this conduct for what it is, a classic horizontal conspiracy to drive out competition, which should be subjected to the harshest form of antitrust condemnation, "per se" illegality.

125. House Report, supra note 98 at 15.

126. Citing, Spray-Rite Service Corporation v. Monsanto Company, 684 F.2d 1226, 1238-1239 (7th Cir. 1982); Girardi v. Gates Rubber Company Sales Division, Inc., 325 F.2d 196 (9th Cir. 1963).

127. Citing, Battle v. Lubrizol Corp., 673 F.2d 984 (8th Cir. 1982), vacated on rehearing en banc by an equally divided court, 712 F.2d 1238 (8th Cir. 1983); Filco v. Amana Refrigeration, Inc.,

709 F.2d 1257 (9th Cir.), cert. dismissed, 104 S.Ct. 243 (1983); Bostick Oil Co. v. Michelin Tire Corp., 702 F.2d 1207 (4th Cir.), cert. denied, 104 S.Ct. 243 (1983); Blankenship v. Herzteld, 661 F.2d 840 (10th Cir. 1981); Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105 (3d Cir. 1980), cert. denied, 451 U.S. 911 (1981).

128. Roesch, Inc. v. Star Cooler Corp., 671 F.2d 1168 (8th Cir. 1982), aff'd on rehearing by an equally divided court, 712 F.2d 1235, 1237 (8th Cir. 1983), cert. denied, 104 S.Ct. 1707 (1984); Bruce Drug Inc. v. Hollister, Inc., 688 F.2d 853 (1st Cir. 1982).
129. Schwimmer v. Sony Corp. of America, 677 F.2d 946 (2d Cir.), cert. denied, 459 U.S. 1007 (1982); H. L. Moore v. Eli Lilly & Co., 662 F.2d 935 (2d Cir. 1981).
130. Monsanto Company v. Spray-Rite Service Corporation, 465 U.S. 752, 763, 104 S.Ct. 1464, 1470 (1984).
131. United States v. Colgate & Co., 250 U.S. 300, 307, 39 S.Ct. 465, 468 (1919).
132. Monsanto Company v. Spray-Rite Service Corporation, 465 U.S. 752, 763-764, 104 S.Ct. 1464, 1470 (1984).
133. Id., 465 U.S. at 764, 104 S.Ct. at 1471.
134. Id.

135. 637 F.2d 105 (3d Cir. 1980).
136. Id. at 123 (Sloviter, C. J., dissenting).
137. Id.
138. Id.
139. Id.
140. Id. at 124. Citing, Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979) (recognizing that when a manufacturer takes action at the behest of a customer, such action can no longer be considered unilateral and is therefore subject to the prohibitions of the antitrust laws); Mannington Mills, Inc. v. Congoleum Industries, Inc., 610 F.2d 1059, 1069-70 (3d Cir. 1979) (holding that allegations that Congoleum terminated plaintiff's foreign licenses "in response to" complaints by Congoleum's foreign licensees about plaintiff's excessive competition and to the foreign licensees' threats to terminate their own licenses stated a sufficient claim under the antitrust laws).
141. For example, on similar facts the court in Girardi v. Gates Rubber Company Sales Division, Inc., 325 F.2d 196, 200 (9th Cir. 1963), stated:

It seems to us to be clear that if the facts here, as claimed by the appellant, are that Oranges as a competitor of Girardi, the price cutter, induced and participated in action which resulted in Girardi being cut off from a supply



of this merchandise, then the case would be precisely within the rationale of United States v. Socony-Vacuum Oil Co., supra, for it is normally the competitor who is being hurt by price cutting who is likely to seek coercive action against the competitor who is hurting or likely to hurt him. We would think that a typical case of illegal conspiracy to fix prices would arise from the desire of one dealer to eliminate his price cutting competitor through concerted action with the manufacturer.

142. 637 F.2d at 125, citing, Eastern States Retail Lumber Dealers' Association v. United States, 234 U.S. 600, 34 S.Ct. 951 (1914); Interstate Circuit, Inc. v. United States, 306 U.S. 208, 59 S.Ct. 467 (1939); American Tobacco Co. v. United States, 328 U.S. 781, 66 S.Ct. 1125 (1946); United States v. Parke, Davis & Co., 362 U.S. 29, 80 S.Ct. 503 (1960).

143. Id. at 126-128, 131. Another untoward consequence of the narrow Texaco/Monsanto focus on a "mechanistic search for direct evidence of a combination" (Id. at 130.) is that it diverts attention from the more significant issue, which is: whether antitrust law ought to permit one or a group of competitors to squeeze out discounters by pressuring a mutual supplier to control or cut the discounter out of the market, and escape liability on the ground that the supplier's action was wholly "vertical" or "unilateral." As noted by Judge Sloviter

Underlying the majority's out-of-hand rejection of the possibility that there was a combination in this case may be its belief that such conduct does not or should not violate the antitrust laws. However, that confuses two separate issues: whether there was conduct that can fairly be considered to

have been joint or concerted, and the standard by which such conduct should be evaluated for purposes of antitrust liability. (Id.)

144. House Report, supra note 98 at 20, citing Flynn, Vertical Restraints After Monsanto, 71 CORN. L. REV. 1095 (1986).

145. Chief Justice Earl Warren once stated in Brown Shoe Co. v. United States, 370 U.S. 294, 82 S.Ct. 1502 (1962), that "it is competition not competitors" (370 U.S. at 344, 82 S.Ct. at 1534) that the antitrust laws protect. This unfortunate statement has acquired a life of its own, often used to support broad statements that the fate of individual competitors, such as small dealers or discount stores, are of no concern to antitrust law. As Professor Easterbrook once noted:

Whatever role political values play in antitrust, surely they do not call for courts to protect these market participants at the expense of consumers. Such protectionism turns antitrust on its head. Antitrust protects competition, not competitors. (Easterbrook, supra note 15 at 152.)

This assertion is simply wrong. Antitrust law exhibits a substantial concern with protecting individual participants in a variety of business settings against coercion, collusion, or exclusionary activities by their competitors, suppliers, or customers. For example, if antitrust had no concern for individual market participants, it would not permit private enforcement of the law, with its battery of remedies including injunctive relief (Clayton Act § 16, 15 U.S.C. § 26) and treble damage awards, which accrue to the benefit of "any person who

shall be injured in his business or property by reason of anything forbidden in the antitrust laws." Clayton Act § 4, 15 U.S.C. § 15 (emphasis added). Indeed, Chief Justice Warren's statement when placed in context indicates a healthy antitrust concern for competitors:

The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

370 U.S. at 344, 82 S.Ct. at 1534 (emphasis added). And as Professor Cann has noted:

a working definition of competition should reflect some deference to legislative intent and the concerns for entrepreneurial opportunity, business initiative, decentralized decision-making, and power diffusion.

Cann, supra note 71 at 526, citing Fox, The Modernization of Antitrust: A New Equilibrium, 66 CORNELL L. REV. 1140, 1153-55, 1182-90 (distrust of power and entrepreneurial opportunity); Panel Discussion: Merger Enforcement and Practice, 50 ANTITRUST L.J. 233, 237-38 (1982) (comments of Steve Axinn) (competition "refers to an entire process which has preserved a system of

entry and exit"); H.R. Rep. No. 99-162, 99th Cong., 1st Sess. 7 (1985) ("competitive decentralized social and economic system," "opportunities for business initiative," "opportunities for small business").

And as Professor Sullivan has noted:

The antitrust laws do not deal solely with problems of allocative efficiency. In passing the Sherman and Clayton acts Congress was also concerned to protect the freedom of individual traders to make for themselves, free of compulsion or coercion, decisions about the markets they would enter, the prices they would charge and, in general, how they would compete.

SULLIVAN, supra note 27 at 376, citing, Kiefer-Stewart Co. v. Jos. E. Seagram & Sons, Inc., 340 U.S. 211, 213, 71 S.Ct. 259, 260 (1951); United States v. A. Schrader's Son, Inc., 252 U.S. 85, 100, 40 S.Ct. 251, 253 (1920).

And as the House Report accompanying the currently pending "Freedom from Vertical Price Fixing Act of 1987" notes:

[W]ithout competitors, there would be no competition. To benefit consumers, competition should be present at all levels of the manufacturing and distribution system. If retailers are inefficient or engaged in anticompetitive activity, the gains to consumers from competitive performance further upstream in the distribution system can be wiped out.

House Report, supra note 98 at 11-12.

And as Judge Browning noted in his classic dissent in the Court of Appeals opinion in GTE Sylvania:

Legislative history and Supreme Court decisions establish that a principal objective of the Sherman Act was to protect the right of independent business entities to make their own competitive decisions, free of coercion, collusion, or exclusionary practices.

Congress' general purpose in passing the Sherman Act was to limit and restrain accumulated economic power, represented by the trusts, and to restore and preserve a system of free competitive enterprise. The congressional debates reflect a concern not only with the consumer interest in price, quality, and quantity of goods and services, but also with society's interest in the protection of the independent businessman, for reasons of social and political as well as economic policy.

The Supreme Court has implemented the statutory policy of protecting the independence of individual business units in a series of decisions banning resale price maintenance agreements. . . .

The same theme of protecting the right of independent business entities to compete runs through Supreme Court decisions holding group boycotts illegal per se. . . .

In many other contexts, the Supreme Court has rested decisions upon the premise that protection of the freedom to compete of separate business entities is an important objective of the Sherman Act. . . .

From the holdings and rationale of these and other Supreme Court decisions, "it seems clear that the protection of individual traders from unnecessary restrictions upon their freedom of action is a significant independent objective of antitrust policy." As a commentator recently put it, "The most important of the social policy objectives found in the Court's antitrust decisions are the concepts of business independence and freedom of business opportunity." In Judge Hand's well-known words, Congress was not "actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the directions of a few. These considerations, which we have suggested as possible purposes of the Act, we think the decisions prove to have been in fact its purposes.

GTE Sylvania, Incorporated v. Continental T.V., Inc., 537 F.2d 980, 1018-1021 (9th Cir. 1976) (Browning, J., dissenting).

And as forcefully reiterated by the Supreme Court in United States v. Topco Associates, Inc.:

Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete--to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster.

405 U.S. 596, 610, 92 S.Ct. 1126, 1135 (1972).

Defining competition by focusing upon the conduct of market participants is not only supported by the language of the antitrust laws and the cases, it is also the only definition capable of judicial application in the context of a specific case. Consider, for example, the definition of competition posed by the Chicago School: any state of affairs or any allocation of resources in which consumer welfare is maximized. (See, for example, BORK, supra note 15, at 58-61, 137 and Judge Posner's opinion in Roland Machine Company v. Dresser Industries, 749 F.2d 380, 395 (7th Cir. 1984).) Even if we disregard the Chicago School's "counterintuitive" definition of "consumer," which includes monopolists and cartels (see discussion in Lande I, supra note 69 at 28; see also HOVENKAMP supra note 70 at 45-49), and define the term in its ordinary legal sense to include persons who purchase goods or services for personal, family, or household use (see, for example, the definition in the Magnuson Moss Warranty Act at 15 U.S.C. §§ 2301(1),(3); see also, Uniform Commercial Code § 9-109(1)), a consumer welfare definition of competition provides no workable legal standard. It focuses incorrectly on the recipients or beneficiaries of the

competitive process, rather than upon the conduct of the participants in the process itself. Even if consumer welfare is to be the guiding standard, isn't it likely that consumers will be "better off" (in the sense of having a wider range of choice regarding goods, services, and prices) if the market participants who provide those goods and services are acting without collusion, coercion, or other activities which artificially restrict the availability or inflate the price of goods or services sold in the economy? In short, the focus of Sherman Act § 1 violations, including vertical restraints of trade, must be on the conduct of the market participants and the effect of that conduct on other competitors.

Focusing antitrust analysis narrowly on the effect of a given activity on the plaintiff should provide a strong inference of its effect on competition, which after all depends upon the vitality of individual competitors in the market. It also provides a standard which is capable of formulation as a legal rule which can be applied in the context of a specific case. Professor Lande recently has noted the extreme complexity of antitrust law (Lande I, supra note 69 at 28), known only to economists and a few antitrust lawyers, is one factor leading to the widespread acceptance of the Chicago School's "counterintuitive" definition of consumer welfare. This complexity pervades Chicago School analysis and has had a debilitating effect on antitrust enforcement virtually across the board. Antitrust provides the conduct ground rules for

business. It should inform business in fairly clear terms of the parameters of acceptable conduct. Chicago School economic "analysis" has muddied the waters to such an extent that virtually any activity can be justified as "arguably" or "plausibly" procompetitive. Antitrust law means nothing to the preservation of competition unless every person in business knows what the rules are and can recognize violations.

146. House Report, supra note 98 at 20-21. On March 1, 1989 Professor John J. Flynn of the University of Utah College of Law noted at a District of Columbia Bar seminar that in recent years more than 50% of antitrust cases have been dismissed on summary judgment grounds and that there has been a 47% decline in private antitrust suits. 56 ATRR 365 (Mar. 9, 1989).

147. Quoting, Poller v. Columbia Broadcasting System, 368 U.S. 464, 473, 82 S.Ct. 486, 491 (1962).

148. The House Report goes on to note:

It should be remembered that under the Rule 56 of the Federal Rules of Civil Procedure, a summary judgment will not lie if the dispute about a material fact is "genuine"--that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party. In Adickes v. S. H. Kress & Co., 398 U.S. 144 (1970), the Supreme Court emphasized that the availability of summary judgment turned on whether a proper jury question was presented. There, one of the issues involved whether there was a conspiracy between private persons and law enforcement officers. The district court granted summary judgment for the defendants, stating that there was no evidence from which reasonably-minded jurors might draw an inference of conspiracy. The Supreme Court reversed,



pointing out that the moving party's submissions had not foreclosed the possibility of the existence of certain acts from which "it would be open to a jury . . . to infer from the circumstances" that there had been a meeting of the minds. Id. at 158-159.

From this and other decisions, the court in a recent case, Anderson v. Liberty Lobby, Inc., 106 S.Ct. 2505 (1986), summarized the test under Rule 56 as follows:

". . . it is clear enough from our recent cases that at the summary judgment stage, the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." Id. at 2511.

In short, the inquiry of the court is confined to determining whether a sufficient disagreement exists to require submission to a jury, or whether it is so one-sided that one party must prevail as a matter of law. (House Report, supra note 98 at 21 n. 73.

It is clear that the Monsanto standard is inconsistent with these basic principles, permitting or requiring judges to "weigh the evidence and determine the truth of the matter" on summary judgment evidence, thereby transforming summary judgment in dealer termination cases "away from its traditional focus on 'legal cognizability' to a kind of full-blown 'bench trial on paper'" (Id. at 20).

149. House Report, supra note 98 at 23. See cases discussed at 23-25.
150. Id. at 25. See cases discussed at 23-25.
151. In Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corporation, \_\_\_\_ U.S. \_\_\_\_, 106 S.Ct. 1348 (1986), Justice Powell characterized Monsanto as holding

"conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy." (Id. at 1357.)

As noted in the House Report accompanying the "Freedom from Vertical Price Fixing Act of 1987":

Such a reading of Monsanto appears to increase the standard of proof for the conspiracy element of the offense. To the extent that Matsushita may be taken to imply that a defendant's hypothetical explanations, however plausible, may be used to determine whether the evidence submitted by plaintiff "tends to prove a conscious commitment to a common scheme," the opinion appears to go further than the Monsanto holding on the questions of what evidence is legally sufficient to prove conspiracy and whether the factual determination is one for court or jury. (House Report, supra note 98 at 20 n. 69.)

152. See, for example, the statements of various representatives of the discount retail industry at the Senate Judiciary Committee hearings on the Justice Department's Vertical Restraints Guidelines (Senate Hearing, supra note 40 at 81-177). For example, Monroe Milstein, Chairman of the Board of Burlington Coat Factory Warehouse Corporation, testified

In my experience, my company has frequently been deprived of highly valuable merchandise because a large full-price retailer has coerced the manufacturer not to sell to Burlington in certain areas. In many of these areas, Burlington was the only significant off-price retailer. The net result of the cut-off of sales to Burlington has been that in those areas, the only price available to the consumer was the high price charged by full-price stores. (Id. at 82.)

153. \_\_\_\_ U.S. \_\_\_\_, 108 S.Ct. 1515 (1988).

154. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1520-1521, 1523, 1525.
155. See supra notes 112-124 and accompanying text.
156. Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_\_ U.S. \_\_\_\_, \_\_\_\_, 108 S.Ct. 1515, 1528-1529 (1988) (Stevens, J., dissenting).
157. Id., \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1533 (Stevens, J., dissenting).
158. Id., \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1533-1534 (Stevens, J., dissenting).
159. Id., \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1532 (Stevens, J., dissenting).
160. Id., \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1536 (Stevens, J., dissenting).
161. See supra notes 125-151 and accompanying text.
162. 310 U.S. 150, 60 S.Ct. 811 (1940).
163. Id., 310 U.S. at 221-223, 60 S.Ct. at 843-844.
164. 435 U.S. 679, 98 S.Ct. 1355 (1978).
165. Id., 435 U.S. at 692, 98 S.Ct. at 1365.
166. House Report, supra note 98 at 38-39 (emphasis in original).

167. NAAG Guidelines, supra note 37 at § 2.1.
168. 362 U.S. 29, 80 S.Ct. 503 (1960).
169. 310 U.S. 150, 223, 60 S.Ct. 811, 844 (1940).
170. Id., 362 U.S. at 47, 80 S.Ct. at 513.
171. National Society of Professional Engineers v. United States, 435 U.S. 679, 692, 98 S.Ct. 1355, 1365 (1978).
172. Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_ U.S. \_\_\_, \_\_\_, 108 S.Ct. 1515, 1525 (1988).
173. Socony Vacuum, supra note 169, 310 U.S. at 221, 223, 60 S.Ct. at 843, 844.
174. House Report, supra note 98 at 23.
175. 250 U.S. 300, 39 S.Ct. 465 (1919).
176. 465 U.S. at 761, 104 S.Ct. at 1469.
177. \_\_\_ U.S. at \_\_\_, 108 S.Ct. at 1520.
178. 272 U.S. 476, 47 S.Ct. 192 (1926), cited with approval in Business Electronics Corporation v. Sharp Electronics Corporation, \_\_\_ U.S. \_\_\_, \_\_\_, 108 S.Ct. 1515, 1524 (1988).
179. 362 U.S. 29, 80 S.Ct. 503 (1960). Note that in Monsanto the court stated in a footnote that:

The concept of "a meeting of the minds" or "a common scheme" in a distributor-termination case includes more than a showing that the distributor conformed to the suggested price. It means as well that evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer. (465 U.S. at 764 n.9, 104 S.Ct. at 1471 n. 9.)

It has been suggested that this language casts some doubt on the continuing precedential value of cases such as Parke Davis and Albrecht, which involved combinations created by restraints imposed on dealers and customers by coercive conduct. (See, for example, Dimidowich v. Bell & Howell, 803 F.2d 1473, 1478 (9th Cir. 1986); Jack Walters & Sons Corp. v. Morton Building, Inc., 737 F.2d 698, 707 (7th Cir.), cert. denied, 105 S.Ct. 432 (1984).

180. 390 U.S. 145, 88 S.Ct. 869 (1968).

181. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1525.

182. United States v. General Electric Co., 358 F.Supp. 731 (S.D.N.Y. 1973).

183. 377 U.S. 13, 84 S.Ct. 1051 (1964).

184. 377 U.S. at 18, 21-22, 84 S.Ct. 1055, 1057.

185. \_\_\_\_ U.S. \_\_\_\_, 108 S.Ct. at 1524.

186. \_\_\_\_ U.S. \_\_\_\_, 84 S.Ct. at 1061 (Stewart, J., dissenting).

187. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1525.

188. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1532 (Stevens, J., dissenting).
189. 388 U.S. 350, 87 S.Ct. 1847 (1967).
190. 405 U.S. 596, 92 S.Ct. 1126 (1972).
191. \_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1536 (Stevens, J., dissenting).
192. BORK, supra note 15 at 406.
193. See H.R. 585, "The Freedom from Vertical Price Fixing Act of 1987," accompanied by H.R. Rep. No. 100-421, 100th Cong., 1st Sess. (1987); S. 430, "The Retail Competition Enforcement Act of 1987," accompanied by S. Rep. No. 100-280, 100th Cong., 2d Sess. (1987). A similar bill, the "Price Fixing Prevention Act of 1989," (H.R. 1236), was introduced by House Judiciary Committee Chairman Jack Brooks on March 2, 1989. See, 56 ATRR 363 (Mar. 9, 1989).
194. Language of H.R. 585.
195. Language of S. 430.
196. Id.
197. Language of H.R. 585.
198. Another weakness of the pending bills is the sponsors' apparent willingness to limit the scope of per se illegality to conspiracies to fix minimum resale prices (See, for example, 55 ATRR 4-5 (July 7, 1988)). The rationale for exempting maximum

resale price fixing is apparently that in newspaper distribution, independent distributors are granted exclusive territories and maximum price fixing is necessary to prevent price gouging. The bankruptcy of this reasoning was, of course, long ago exposed by Justice White in Albrecht v. The Herald Company, 390 U.S. 145, 154, 88 S.Ct. 869, 874 (1968):

The assertion that illegal price fixing is justified because it blunts the pernicious consequences of another distribution practice is unpersuasive. If . . . the economic impact of territorial exclusivity was such that the public could be protected only by otherwise illegal price fixing itself injurious to the public, the entire scheme must fall under § 1 of the Sherman Act.

199. In the words of Justice Stevens:

I have emphasized in this dissent the difference between restrictions imposed in pursuit of a manufacturer's structuring of its product distribution, and those imposed at the behest of retailers who care less about the general efficiency of a product's promotion than their own profit margins. Sylvania stressed the importance of the former, not the latter; we referred to the use that manufacturers can make of vertical nonprice restraints . . . and nowhere did we discuss the benefits of permitting dealers to structure intrabrand competition at the retail level by coercing manufacturers into essentially anticompetitive agreements. (\_\_\_\_ U.S. at \_\_\_\_\_, 108 S.Ct. at 1536 (Stevens, J., dissenting)).

200. In Business Electronics, the majority opinion itself admits:

[A]ll vertical restraints, including the exclusive territory agreement held not to be per se illegal in GTE Sylvania, have the potential to allow dealers to increase "prices" and can be characterized as intended to achieve just that. In fact, vertical nonprice restraints only accomplish the benefits identified in GTE Sylvania because they reduce

intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services. . . . (\_\_\_\_ U.S. at \_\_\_\_, 108 S.Ct. at 1521-1522).

201. United States v. Topco Associates, Inc., 405 U.S. 596, 610, 92 S.Ct. 1126, 1135 (1972).











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