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Antitrust: Business Electronics Corp. v. Sharp Electronics Corp.-A Better Rule For Vertical Restraints, But Is It Legal?

Scott G. Crowley

NOTES

Antitrust: *Business Electronics Corp. v. Sharp Electronics Corp.*—A Better Rule For Vertical Restraints, But Is It Legal?

I. INTRODUCTION

In *Business Electronics Corp. v. Sharp Electronics Corp.*,[1] the United States Court of Appeals for the Fifth Circuit caused a stir in antitrust circles by holding that a manufacturer's termination of a discount retailer, in an effort to stabilize resale prices, was not illegal per se.[2] The court rejected the district court's conclusion that the termination was a per se illegal price restraint[3] because there was no explicit price fixing agreement

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1. 780 F.2d 1212 (5th Cir. 1986), *cert. granted*, 107 S. Ct. 3182 (1987).

2. The applicable statute is the Sherman Act, 15 U.S.C. § 1 (1982). It makes illegal "[e]very contract, combination . . . or conspiracy, in restraint of trade."

In theory, per se illegality is to be used sparingly in antitrust law. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 50-51 (1977). The Supreme Court, in Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958), defined per se illegality and outlined its proper use:

> [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

See also Sylvania, 433 U.S. at 50 n.16.

3. A restriction on price, also known as price fixing or resale price maintenance, "refers to agreements between persons at different levels of the market structure establishing the resale price or price ranges of products or services." ABA, ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 56 (2d ed. 1984 & Supp. 1986)[hereinafter DEVELOPMENTS]. Price restrictions, as used in this note, encompass both explicit price fixing and price stabilization. No relevant distinction between the two was recognized prior to *Business Electronics*, but the Fifth Circuit based its holding on such a distinction. A hand-

between the conspiring parties. Consequently, the fifth circuit became the first court to require an explicit price fixing agreement prior to finding a per se violation of the antitrust laws.

Business Electronics is a "cat's paw"[4] distributor termination case in which a supplier terminated a discounting retailer at the behest of a competing retailer in an effort to stabilize resale prices. The court's decision is significant because it judged this type of vertical restraint[5] by a different standard. Whereas numerous federal court opinions established the per se illegality of a termination in response to a competitor's desire to eliminate intrabrand price competition,[6] the fifth circuit has now taken

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book for vertical restraints is ABA, ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION (1977) [hereinafter MONOGRAPH NO. 2]. For the most recent cases, however, see ABA ANTITRUST SECTION DEVELOPMENTS, at 55-103.

4. A supplier or manufacturer acts as a "cat's paw" for its distributors when it restricts a "free riding" distributor for the purpose of maintaining the retail prices of full-price/full-service distributors. *See* Illinois Corporate Travel, Inc. v. American Airlines, Inc. 806 F.2d 722, 726 (7th Cir. 1986). The facts are discussed *infra*, notes 11-16 and accompanying text. The law regarding distributor terminations is discussed *infra*, notes 17-64 and accompanying text.

5. "Vertical restrictions frequently are designed to limit the conditions under which firms may resell products or the conditions under which customers may purchase products." ABA, ANTITRUST SECTION, DEVELOPMENTS, *supra* note 3, at 55-56. "A vertical relationship involves firms at different levels of the market—e.g., between a manufacturer and its wholesale or retail distributors—as opposed to a horizontal relationship among firms at the same market level—e.g., an arrangement among competing manufacturers or among competing distributors." ANTITRUST ADVISOR § 2.01 (C. Hills 3d ed. 1985).

Vertical restraints generally arise in one of three contexts. One is agreement to the restriction, express or implied, or at least acquiescence to it. Another involves the use of outside entities, such as wholesalers or other retailers, to enforce the restraint. *See* Bowen v. New York News, Inc., 366 F. Supp. 651, 658 (S.D.N.Y. 1973), *aff'd*, 522 F.2d 1242 (2d Cir. 1975), *cert. denied*, 425 U.S. 936 (1976). These situations may be analyzed alternatively as horizontal restrictions at the retail level, i.e., group boycotts. *See* United States v. General Motors Corp., 384 U.S. 127 (1966). Dealers in the *General Motors* case joined together in seeking the assistance of the manufacturer in suppressing discounting. The Supreme Court invalidated a scheme whereby the manufacturer elicited promises from its distributors not to deal with discounters and other dealers enforced compliance with these promises. *Id.* at 132-38, 143-45. *See also* Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 209-14 (1959)(Court found illegal a conspiracy between manufacturers and distributors not to sell appliances to a discounter).

A third context is the termination of a dealer in response to complaints of price cutting from competing dealers. *See* Albrecht v. Herald Co., 390 U.S. 145, 149-55 (1968)(termination and offer of reinstatement upon promise to obey maximum price restrictions is illegal per se). This third context is a type of manufacturer "refusal to deal," which is the situation wherein *Business Electronics* arises. For discussion of refusals to deal, see P. AREEDA, ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES 712-32 (3d ed. 1981); L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST §§ 139-41 (1977).

6. *See infra* notes 31-43 and accompanying text.

Not every termination of a distributor is illegal as a resale price maintenance agree-the position that no agreement to terminate a dealer is unlawful per se without an accompanying agreement to "set [resale] prices at some level."[7] The difference in the fifth circuit's approach is that terminations which reduce intrabrand competition and stabilize retail prices without actually fixing them are judged according to their impact on competition, that is, under the rule of reason.[8]

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ment. For instance, it is completely within the manufacturer's right to discharge an unsatisfactory dealer. *See* cases cited in ABA, ANTITRUST SECTION, DEVELOPMENTS, *supra* note 3, at 102 nn.706-11. It is also within the manufacturer's right to discharge superfluous dealers. *See* Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd., 416 F.2d 71, 78 (9th Cir. 1969), *cert. denied,* 396 U.S. 1062 (1970)(manufacturer decision to terminate one distributor to receive better distribution from another is legal). Replacing one dealer with another is also permissible. Burdett Sound, Inc. v. Altec Corp., 515 F.2d 1245, 1249 (5th Cir. 1975)("[I]t is simply not an antitrust violation for a manufacturer to contract with a new distributor, and as a consequence, to terminate his relationship with a former distributor, even if the effect of the new contract is to seriously damage the former distributor's business."); Ace Beer Distribs., Inc. v. Kohn, 318 F.2d 283, 287 (6th Cir.), *cert. denied,* 375 U.S. 922 (1963)("The substitution of one distributor for another in a competitive market of the kind herein involved does not eliminate or materially diminish the existing competition of distributors of other beers, is not an unusual business procedure, and, in our opinion, is not an unreasonable restraint of trade."). *See also* A.H. Cox & Co. v. Star Mach. Co., 653 F.2d 1302, 1306 (9th Cir. 1981); Universal Brands, Inc. v. Phillip Morris, Inc., 546 F.2d 30, 33 (5th Cir. 1977); Quality Mercury, Inc. v. Ford Motor Co., 542 F.2d 466, 469 (8th Cir. 1976), *cert. denied,* 433 U.S. 914 (1977); Dreibus v. Wilson, 529 F.2d 170, 173-74 (9th Cir. 1975), *cert. denied,* 426 U.S. 908 (1976); Bowen v. New York News, Inc., 522 F.2d 1242, 1254 (2d Cir. 1975), *cert. denied,* 425 U.S. 936 (1976); Ark Dental Supply Co. v. Cavitron Corp., 461 F.2d 1093, 1094 (3rd Cir. 1972).

It is typically assumed, though, that a termination motivated by price is done to enforce a price restriction. Accordingly, the termination of a price cutter to either penalize the violation of an existing price agreement or in connection with an agreement contemporaneously entered into between the manufacturer and the nonterminated dealer is a per se contravention of the Sherman Act. The *Business Electronics* decision, however, constitutes an attempt to distinguish the termination of a price cutter when no price fixing agreement is entered. In this situation the *Business Electronics* court would apply a reasonableness standard. *See infra* notes 102-05 and accompanying text.

7. Business Elecs. Corp. v. Sharp Elecs. Corp., 780 F.2d 1212, 1218, (5th Cir. 1986), *cert. granted,* 107 S. Ct. 3182 (1987).

8. Under the rule of reason standard, the court is to analyze a restraint's economic effect. If the restraint does not unreasonably restrain trade, it is valid. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 49-50 (1977); National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 687-92 (1978). For a definition and an example of the rule of reason as applied, see Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)(Brandeis, J.).

Much literature exists advocating the need to judge vertical restraints by their impact on competition. *See* Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is* Sylvania *A Way Out?,* 67 VA. L. REV. 1457, 1458 (1981); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* [II] 75 YALE L.J. 373, 373-465 (1966); Hay, *Vertical Restraints After* Monsanto, 70 CORNELL L. REV. 418, 436-44 (1985); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality,* 48 U. CHI. L. REV. 6, 14-26 (1981) [hereinafter

The thesis of this Note is two-fold: First, the distinction drawn in *Business Electronics* between direct price fixing and indirect price stabilization violates years of Sherman Act interpretation; also, that the fifth circuit erroneously relied on the Supreme Court decision of *Monsanto Co. v. Spray-Rite Service Corp.* as authority for its conclusion.[9] Second, the analysis of *Business Electronics* is based upon solid economic principles, and it resolves an evidentiary problem and partially resolves an analytic problem stemming from prior Sherman Act interpretations. In short, although *Business Electronics* contravenes precedent and higher authority, it develops a more economically sound rule. Since the Supreme Court has granted certiorari,[10] *Business Electronics* may greatly affect the future of antitrust law.

II. The *Business Electronics* Case

Sharp Corporation, a manufacturer of electronic instruments, was represented in the Houston area exclusively by Business Electronics Corporation ("BEC"), a discount retailer.[11] Sharp eventually became displeased with BEC and hired Gilbert Hartwell as a second dealer. Within a short time Hartwell began to complain of BEC's price cutting and threatened to sell his own dealership if Sharp did not terminate BEC. In response, Sharp terminated BEC.

BEC sued Sharp, claiming that BEC was terminated pursuant to a price stabilization agreement and that the agreement constituted a per se violation of section one of the Sherman Act. However, Sharp contended that it terminated BEC because of its free riding.[12] Indeed, Hartwell testified that his primary concern was not that BEC was discounting prices, but that BEC

The Next Step]; Posner, *The Rule of Reason and the Economic Approach: Reflections On the* Sylvania *Decision,* 45 U. Chi. L. Rev. 1, 12-13 (1977) [hereinafter *Reflections*]; Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* 75 Colum. L. Rev. 282, 283-99 (1975) [hereinafter *Analysis*]; *see also* cases cited in Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1437 (7th Cir. 1986). *Contra* Hovenkamp, *Antitrust Policy After Chicago,* 84 Mich. L. Rev. 213 (1986).

9. 465 U.S. 752 (1984). *Monsanto* is discussed *infra* notes 44-47 and accompanying text. The other cases are discussed *infra* notes 31-39 and accompanying text.

10. 107 S. Ct. 3182 (1987).

11. The facts are found in 780 F.2d at 1214-15.

12. For a definition and discussion of "free riding," see *infra* notes 54-57 and accompanying text.

was profiting from Hartwell's investment in product services and other nonprice competition.[13] Nevertheless, the jury found that BEC was terminated to insulate Hartwell from price competition. The court instructed the jury that "[t]he Sherman Act is violated when a seller enters into an agreement or understanding with one of its dealers to terminate another because of the other dealer's price cutting."[14]

On appeal, Sharp did not dispute the possibility that an agreement existed to terminate BEC in response to BEC's price cutting. However, Sharp contended that such action is not illegal per se. The court of appeals agreed and reversed. Focusing on the absence of an explicit price fixing agreement, the court held that there can be no per se violation of the Sherman Act where there exists only an abstract possibility that the price level will rise. The court stated that "it was not enough for the jury to find that BEC was terminated to reduce price competition; the jury should have been required to find that the termination was pursuant to a price maintenance agreement between Sharp and Hartwell."[15] The court also declared that

> in order for a manufacturer's termination of a distributor to be illegal *per se*, it must be pursuant to a price maintenance agreement with another distributor. That distributor must expressly or impliedly agree to set its prices at some level, though not a specific one. The distributor cannot retain complete freedom to set whatever price it chooses.[16]

III. *Business Electronics* AND THE LAW OF VERTICAL PRICE RESTRAINTS

The fifth circuit was the first to require an explicit price fixing agreement before holding a cat's paw distributor termination unlawful on its face. Other courts have not drawn a distinction between price fixing and price stabilization for purposes of applying the per se rule. Rather, other courts hold that "if a manufacturer deliberately withdraws its product from a price-cutting distributor at the request of a competing distributor as part of a conspiracy to protect the requesting distributor from price competition, the manufacturer has committed a per se violation of

13. 780 F.2d at 1215.
14. *Id.*
15. *Id.* at 1216.
16. *Id.* at 1218.

the antitrust laws."[17] Therefore, the holding in *Business Electronics* is contrary to the established law of vertical price restraints. Moreover, the fifth circuit erroneously relied on the Supreme Court case of *Monsanto Co. v. Spray-Rite Service Corp.*[18] to support its conclusion. The following sections review the law of vertical price restraints and the *Monsanto* decision.

A. *Vertical Price Restrictions*

Vertical price restrictions, at least in the form of explicit price fixing agreements, have been illegal per se since the early case of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[19] The Dr. Miles company manufactured pharmaceuticals and made most of its sales through retail druggists. The company depended on the druggists' loyalty to the product for the cultivation of good will among consumers. Department stores also carried the product and began to undercut the druggists with their capacity to sell at a discount price. To protect the druggists from price competition, Dr. Miles established minimum resale prices. The Supreme Court found this interference illegal, declaring that "agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer."[20]

At the very least, *Dr. Miles* stands for the proposition that an explicit vertical price fixing agreement is illegal on its face. However, an important exception to the *Dr. Miles* rule is that vertical price restrictions established unilaterally by the manufacturer are permissible. This is because section one of the Sherman Act is applicable only to agreements. In *United States v. Colgate & Co.*,[21] the Supreme Court declared that "in the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business,

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17. Zidell Exploration, Inc. v. Conval Int'l, Ltd., 719 F.2d 1465, 1469 (9th Cir. 1983); *see also* 780 F.2d at 1216.

18. 465 U.S. 752 (1984).

19. 220 U.S. 373, 404-09 (1911). Horizontal price and nonprice restrictions have been illegal per se since Standard Oil Co. v. United States, 221 U.S. 1, 49-70 (1911).

20. 220 U.S. at 408.

21. 250 U.S. 300 (1919).

freely to exercise his own independent discretion as to parties with whom he will deal."[22]

Over the years, however, the definition of "agreement" or "concerted action" as an element of an antitrust violation has expanded to the point that a defense of unilateralness under *Colgate* is difficult to make.[23] For example, a manufacturer is now prohibited from enforcing a restriction by assuring retailers that competitors will likewise uphold prices,[24] from encouraging outside entities to report violations,[25] or from renewing terminated dealers on the condition of future compliance with a pric-

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22. *Id.* at 307. Interestingly, the indictment did not charge the defendants with selling their products to dealers under minimum resale price agreements. Rather, it merely charged the defendants with refusing to sell to dealers that did not adhere to suggested prices. United States v. Colgate & Co., 253 F. 522, 527 (E.D. Va. 1918), *aff'd*, 250 U.S. 300 (1919); Baker, *supra* note 8, at 1474-75.

23. The general trend had been to narrow *Colgate* by expanding the meaning of the term "combination" under § 1 of the Sherman Act. *See* Baker, *supra* note 8, at 1477-83; Comment, *The* Colgate *Doctrine: Its Past and Present,* 12 HOUS. L. REV. 409. 414 (1975).

The Federal Trade Commission declared the *Colgate* doctrine dead in Russell Stover Candies, Inc, 100 F.T.C. Decisions 1, 20-47 (1982), *rev'd,* Russell Stover Candies, Inc. v. FTC, 718 F.2d 256 (8th Cir. 1983). However, the Court of Appeals for the Eighth Circuit reversed the FTC on this point.

According to Professor Hay, "[i]t is certain that whether *Colgate* is read narrowly or broadly, a tension exists between the *Colgate* doctrine and the judicial hostility towards vertical restraints." Hay, *supra* note 8, at 426. Although the Court has narrowed the doctrine, it has not been overruled. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 68 (1977)(White, J., concurring); Albrecht v. Herald Co., 390 U.S. 145, 149 (1968); United States v. General Motors Corp., 384 U.S. 127, 143-44 (1966); Simpson v. Union Oil Co., 377 U.S. 13, 17 (1964); United States v. Parke, Davis & Co., 362 U.S. 29, 36-48 (1960); FTC v. Simplicity Pattern Co., 360 U.S. 55, 64 (1959); Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 625-27 (1953); Lorain Journal Co. v. United States, 342 U.S. 143, 155 (1951); United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 721-22 (1944); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 457 (1940); FTC v. Beech-Nut Packing Co., 257 U.S. 441, 451-53 (1922); Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208, 210 (1922); United States v. A. Shrader's Son, Inc., 252 U.S. 85, 96-99 (1920).

However, this rule has been largely criticized in the literature. *See* P. AREEDA, *supra* note 5, at 524-31; L. SULLIVAN, *supra* note 5, at §§ 137-41; Barber, *Refusals to Deal Under the Federal Antitrust Laws,* 103 U. Pa. L. Rev. 847, 851-57 (1955); Fulda, *Individual Refusals to Deal: When Does Single-Firm Conduct Become Vertical Restraint?,* 30 LAW & CONTEMP. PROBS. 590, 592-97 (1965); Levi, *The* Parke, Davis-Colgate *Doctrine: The Ban on Resale Price Maintenance,* 1960 SUP. CT. REV. 258, 319-26; Pitofsky & Dam, *Is the* Colgate *Doctrine Dead?,* 37 ANTITRUST L.J. 772, 774-75 (1968); Comment, *Unilateral Refusals to Deal: King* Colgate *is Dead!,* 30 OHIO ST. L.J. 537, 538-42 (1969); Annotation, *Refusals to Deal as Violations of the Federal Antitrust Laws (15 USCS §§ 1, 2, 13),* 41 A.L.R.FED. 175, 230-32 (1979).

24. United States v. Parke, Davis & Co., 362 U.S. 29, 31-37 (1960).

25. Bowen v. New York News, Inc., 366 F. Supp. 651, 658 (S.D.N.Y. 1973), *aff'd*, 522 F.2d 1242 (2d Cir. 1975), *cert. denied,* 425 U.S. 936 (1976).

ing plan.[26] Indeed, anything beyond the "mere announcement of [the manufacturer's pricing] policy and the simple refusal to deal"[27] falls outside the protected scope of *Colgate*. Thus, although the *Colgate* defense is still available,[28] there is a prevalent notion that only unilateral restraints of "Doric simplicity"[29] can avoid the per se reach of *Dr. Miles*. Accordingly, the fifth circuit in *Business Electronics* did not use the *Colgate* doctrine to extricate Sharp because it could not deny the possibility of concerted action: "While it is true that there was little, if any, direct evidence that Sharp and Hartwell reached an agreement as to price, we think the jury reasonably could infer such an agreement from the evidence as a whole."[30]

In time the *Dr. Miles* principle was also expanded from prohibiting retail price setting to prohibiting concerted action to merely stabilize prices. For example, in *United States v. Socony-Vacuum Co*,[31] the Supreme Court held that

> any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, *to the extent that they raised, lowered or stabilized prices they*

26. Albrecht v. Herald Co., 390 U.S. 145, 147-49 (1968).

27. *Parke, Davis*, 362 U.S. at 44.

28. This is especially true after the Supreme Court case of Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984). *See also* Beach v. Viking Sewing Mach. Co., 784 F.2d 746, 749 (6th Cir. 1986); Fragale & Sons Beverage Co. v. Dill, 760 F.2d 469, 473 (3rd Cir. 1985); Becker v. Egypt News Co. 713 F.2d 363, 366 (8th Cir. 1983); Aladdin Oil Co. v. Texaco, Inc., 603 F.2d 1107, 1113-16 (5th Cir. 1979); Daniels v. All Steel Equip., Inc., 590 F.2d 111, 112-13 (5th Cir. 1979); Lamb's Patio Theatre, Inc. v. Universal Film Exchs., Inc., 582 F.2d 1068, 1070 (7th Cir. 1978); Fulton v. Hecht, 580 F.2d 1243, 1249-50 (5th Cir. 1978), *cert. denied*, 440 U.S. 981 (1979); Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 130-33 (2d Cir.), *cert. denied*, 439 U.S. 946 (1978); Fount-Wip, Inc., v. Reddi-Wip, Inc., 568 F.2d 1296, 1300-01 (9th Cir., 1978); Quality Mercury, Inc. v. Ford Motor Co., 542 F.2d. 466, 469 (8th Cir. 1976), *cert. denied*, 433 U.S. 914 (1977); Venzie Corp. v. United States Mineral Prods. Co., 521 F.2d 1309, 1312-16 (3d Cir. 1975); Burdett Sound, Inc. v. Altec Corp., 515 F.2d 1245, 1248-49 (5th Cir. 1975); Brandeis Mach. & Supply Corp. v. Barber-Greene Co., 503 F.2d 503, 505 (6th Cir. 1974); Adolph Coors Co. v. FTC, 497 F.2d 1178, 1184-85 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); Butera v. Sun Oil Co., 496 F.2d 434, 436-37 (1st Cir. 1974).

29. George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787, 790 (2d Cir. 1960)(suggesting that "[t]he Supreme Court has left a narrow channel through which a manufacturer may pass even though the facts would have to be of such Doric simplicity as to be somewhat rare in this day of complex business enterprise.").

30. Business Elecs. Corp. v. Sharp Elecs. Corp., 780 F.2d 1212, 1219 (5th Cir. 1986), *cert. granted*, 107 S. Ct. 3182 (1987).

31. 310 U.S. 150 (1940).

> *would be directly interfering with the free play of market forces.*[32]

Although *Socony-Vacuum* arose in the context of horizontal price fixing,[33] its principle is applicable to all conspiracies which affect price. For example, the Court further stated that "the machinery employed by a combination for price-fixing is immaterial." Moreover, "[u]nder 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*."[34] Similarly, in *National Society of Professional Engineers v. United States*, the Court declared that "an agreement that 'interferes with the setting of price by free market forces' is illegal on its face."[35]

Lower courts have applied the per se rule to vertical conspiracies designed to affect price. For example, the fourth circuit in *Bostick Oil Co. v. Michelin Tire Corp.*,[36] when a tire dealer was terminated for under cutting other dealers selling the same brand of tire by taking advantage of company discounts for quantity purchases, concluded that "a finding of per se violation of [section one] would result from a factual determination that the termination was in furtherance of competitors' desires to eliminate a price-cutting rival."[37] Similarly, the eighth circuit in *Victorian House, Inc. v. Fisher Camuto Corp.*,[38] when a discount clothier was terminated pursuant to a "price-related conspiracy" between the supplier and another dealer, held that "[a] conspiracy between a wholesaler and one or more of its retailers to terminate a competing retailer on the basis of price constitutes a *per se* violation of the Sherman Act."[39]

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32. *Id.* at 221 (emphasis added).

33. The case involved an agreement between gasoline companies to purchase surplus gasoline on the spot market in order to prevent the price from falling. *Id.* at 177-200.

34. 310 U.S. at 223.

35. 435 U.S. 679, 692 (1978)(quoting United States v. Container Corp. of Am., 393 U.S. 333, 337 (1969)). This case also arose in the horizontal context.

36. 702 F.2d 1207 (4th Cir.), *cert. denied*, 464 U.S. 894 (1983).

37. *Id.* at 1215.

38. 769 F.2d 466 (8th Cir. 1985).

39. *Id.* at 469.

Other circuit courts have reached the same conclusion. For example, the third circuit in Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3rd Cir. 1979), a case in which a discount retailer of kitchen cabinets was terminated at the request of another retailer for price considerations, stated: "If the purpose and effect of the challenged conduct is to restrain price movement and the free play of market forces, it is then illegal *per se*." *Id.* at 169. Also the ninth circuit, in Zidell Exploration, Inc. v. Conval Interna-

In summary, most courts have held that agreements designed to stabilize price levels are judged under the per se rule, whether or not a price is actually set.[40] This approach is sometimes justified by the idea that terminations prompted by complaints from other dealers constitute a horizontal conspiracy at the retail level, which are also illegal per se.[41] But the horizontal conspiracy reasoning is not universally accepted.[42] A more widely accepted justification is that agreements to stabilize prices are just as pernicious as agreements to set price minima.[43]

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tional, Ltd., 719 F.2d 1465 (9th Cir. 1983), when a supplier of foreign-made valves terminated its exclusive distributor at the behest of a sister subsidiary which manufactured valves domestically, held that if "the purpose and impact of the conspiracy is to restrain price competition among distributors [it] is appropriate to apply the [per se rule]." *Id.* at 1469.

Other cases reaching this result include Jayco Sys., Inc. v. Savin Business Machs. Corp., 777 F.2d 306, 317-18 (5th Cir. 1985), *cert. denied,* 107 S. Ct. 73 (1986); Malley-Duff & Assoc., Inc., v. Crown Life Ins. Co., 734 F.2d 133, 140-41 (3rd Cir.), *cert. denied,* 469 U.S. 1072 (1984); JBL Enters. v. Jhirmack Enters., 698 F.2d 1011, 1015 (9th Cir.), *cert. denied,* 464 U.S. 829 (1983).

40. The second circuit court of appeals in Oreck Corp. v. Whirlpool Corp., 579 F.2d 126 (2d Cir.)(en banc), *cert. denied,* 439 U.S. 946 (1978), held that a termination prompted by complaints from a competing dealer did not violate the Sherman Act. But the terminated retailer involved was not the low price dealer, therefore, the termination did not cause the price level to rise—that is, there was no proof that the termination was anti-competitive in purpose or effect. Since the termination did not cause a price increase, *Oreck* can be limited to its facts. A discussion of this case is contained in Comment, *Vertical Agreements to Terminate Competing Distributors:* Oreck Corp. v. Whirlpool Corp., 92 HARV. L. REV. 1160 (1979).

41. *See* Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 168; *see also* L. SULLIVAN, *supra* note 5 § 148; Comment, *Vertical Agreement as Horizontal Restraint:* Cernuto, Inc. v. United Cabinet Corp., 128 U. PA. L. REV. 622, 624 (1980).

Another justification for the *Cernuto* rule was the idea that terminations resulting from complaints from competing dealers required application of a higher standard of scrutiny. In *Cernuto,* the third circuit court of appeals stated "[w]hen a marketing decision, although ostensibly taken by a manufacturer, is in fact the result of pressure from another customer, such a decision must be scrutinized more closely than solely unilateral action might be." 595 F.2d at 168. However, this aspect of *Cernuto* has probably been overruled by the Supreme Court in Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984), where it was held that complaints from competing distributors do not constitute a conspiracy. Cases departing from this higher scrutiny reasoning since *Monsanto* include Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1220 (10th Cir. 1986), *petition for cert. filed,* 55 U.S.L.W. 3259 (U.S. Sept. 22, 1986) (No. 86-484); O.S.C. Corp. v. Apple Computer, Inc., 792 F.2d 1464, 1468-69 (9th Cir. 1986); National Marine Elec. Distribs., Inc. v. Raytheon Co., 778 F.2d 190, 192-93 (4th Cir. 1985); Terry's Floor Fashions, Inc. v. Burlington Indus., Inc., 763 F.2d 604, 610-13 (4th Cir. 1985).

42. Professor Baker has criticized the use of horizontal analysis for purely vertical restraints. Baker, *supra* note 8, at 1518-20.

43. Professor Sullivan has argued:

> 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

Therefore, since courts traditionally do not view price stabilization as being different from price restraints, the distinction drawn in *Business Electronics* that exempts price stabilization from the per se rules does not follow precedent.

B. *The Fifth Circuit's Reliance on* Monsanto

The fifth circuit erroneously claimed that its decision followed directly from the reasoning of *Monsanto Co. v. Spray-Rite Service Corp.*[44] It stated that "[n]othing in *Monsanto* suggests that liability can be found without any evidence of a price fixing agreement. Rather, the language of *Monsanto* can only indicate the Court's belief that a price fixing agreement is a requirement for *per se* liability in distributor termination cases."[45] However, the issue in *Monsanto* was what standard should be used in distinguishing between concerted conduct and unilateral conduct.

In *Monsanto*, a wholesale distributor of agricultural chemicals was terminated by its supplier, and there was evidence that the termination was prompted by complaints from rival distributors. Thus, the terminated distributor challenged the action as per se illegal. However, the Court noted that evidence of complaints from other distributors did not preclude the possibility that the supplier acted unilaterally. The Court held that something more than evidence of complaints was needed to make a section one case.[46] But the Court did not determine what kind of vertical agreements were illegal per se. Nor did it amend the per se approach to price fixing or price stabilization. Rather, the *Monsanto* language which *Business Electronics* used to support its position was stated in a different context.[47] Thus, although

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> manufacturer, that it may, having earlier franchised two or more dealers, agree at the request of one to terminate the others . . . . 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.

L. SULLIVAN, *supra* note 5 § 148 (1977) (quoted in *Cernuto,* 595 F.2d at 166 (1979).

44. 465 U.S. 752 (1984).

45. Business Elecs. Corp. v. Sharp Elecs. Corp., 780 F.2d 1212, 1218 (5th Cir. 1986), *cert. granted,* 107 S. Ct. 3182 (1987).

46. This portion of *Monsanto* is discussed further, *infra* notes 68-70 and accompanying text.

47. A closer look at the *Monsanto* passages referred to in *Business Electronics* impeaches the court's reliance on it for authority. First, the court quoted from *Monsanto:* "[I]t is of considerable importance that independent action by the manufacturer, and concerted action on nonprice restrictions, be distinguished from price-fixing agreements, since under present law the latter are subject to per se treatment and treble damages."

Monsanto held that the antitrust plaintiff's burden is to prove that an actual price-related conspiracy occurred, *Monsanto* cannot stand for the proposition that per se liability is applicable only to price setting.

IV. *Business Electronics* AND THE ECONOMICS OF VERTICAL PRICE AND NONPRICE RESTRAINTS

Although *Business Electronics* violates precedent it is a better rule in economic terms because it attempts to resolve problems created by the Supreme Court's decision to judge nonprice restraints differently from price restraints. There is a grow-

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780 F.2d at 1218 (quoting *Monsanto*, 465 U.S. at 763). However, the Supreme Court did not intend to mean only explicit "price-fixing agreements." Rather, the passage merely summarized the distinctions drawn in Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), United States v. Colgate & Co., 250 U.S. 300 (1919) (*Dr. Miles* and *Colgate* were discussed *supra* notes 19-30 and accompanying text), and Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) (*Sylvania* is discussed *infra* notes 49-53 and accompanying text), regarding the price-nonprice dichotomy and the motive test. *Monsanto*, 465 U.S. at 760-63. Those cases contemplated no distinction between restrictions against price cutters and price maintenance agreements.

Second, *Business Electronics* also relies on the *Monsanto* statement that a plaintiff must show that the "distributors are not making independent pricing decisions." 780 F.2d at 1218 (quoting *Monsanto*, 465 U.S. at 762). Within its full context, however, the statement in *Monsanto* carries another meaning:

> [T]he economic effect of all of the conduct described above—unilateral and concerted vertical price setting, agreements on price and nonprice restrictions—is in many, but not all, cases similar or identical. And judged from a distance, the conduct of the parties in the various situations can be indistinguishable. For example, the fact that a manufacturer and its distributors are in constant communication about prices and marketing strategy does not alone show that the distributors are not making independent pricing decisions.

Monsanto, 465 U.S. at 762 (citation omitted). That statement focuses on the evidentiary problem with the distinction between unilateral and conspiratorial restraints for purposes of *Dr. Miles*, *Colgate*, and United States v. Parke, Davis & Co., 362 U.S. 29, 36-48 (1960) (*Parke, Davis* was discussed *supra* notes 23-27 and accompanying text.) Indeed, the issue in *Monsanto* was the relation between the *Dr. Miles* prohibition of vertical restraints and the *Colgate* exception for unilateral action. The quote relied upon in *Business Electronics* does not confirm that per se illegal combinations must be accompanied by price fixing agreements.

The third passage relied on is:

> 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.

Monsanto, 465 U.S. at 764 n.9. Once again, it is not likely that "acquiescence or agreement" was intended to mean only "price setting" since the distinction was not established before *Business Electronics*. Rather, it is more likely that the words refer to an understanding to insulate a dealer from intrabrand price competition.

ing concern among antitrust observers that the disparate treatment of price and nonprice restrictions causes an evidentiary problem and is analytically inconsistent. The following section reviews the law and economics of nonprice restraints.

A. *The Creation of the Price/Nonprice Dichotomy*

Nonprice restrictions are devices used by manufacturers to direct retail competition away from price and toward service.[48] By limiting retailers to specific territories or customers, intrabrand price competition is reduced. Consequently, the emphasis in competition shifts from price to product services such as trained salesmen, warranty servicing, and image cultivation. If these pre-sale, point-of-sale, and post-sale product services are appreciated by the consumer, the product will be more attractive in relation to those produced by other manufacturers in the industry. Manufacturers also may ensure that nonprice competition needs are met by simply requiring product services contractually.

In *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[49] the Supreme Court declared that vertical nonprice restrictions were to be judged under the rule of reason.[50] The Court established the

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48. Vertical nonprice, or sales, restrictions on distribution are requirements imposed by suppliers on dealers to control the manner in which the product is distributed or marketed. Typically, they consist of limitations on a seller's geographic sales area or customers to which it may sell, or they may be specifications on how the product is presented to the buying public. One commentator described nonprice restrictions as follows:

> Vertical nonprice restrictions are imposed by a supplier for the purpose of controlling the distribution of the supplier's products. Such restrictions generally limit, directly or indirectly, the geographic areas in which, or the customers to whom, distributors can resell the supplier's products. While such restrictions may affect a distributor's prices, they do not directly restrict the distributor's freedom independently to establish the prices at which it will sell the supplier's products or services. Such restrictions also insulate to varying degrees a distributor from intrabrand competition from the supplier's other distributors.

ANTITRUST ADVISOR, *supra* note 5, § 2.14.

49. 433 U.S. 36 (1977).

50. Nonprice restrictions were routinely sustained as reasonable through the 1950's. *See, e.g.*, Chicago Sugar Co. v. American Sugar Ref. Co., 176 F.2d 1, 10 (7th Cir. 1949), *cert. denied*, 338 U.S. 948 (1950); Fosburgh v. California & Hawaiian Sugar Ref. Co., 291 F. 29, 31-36 (9th Cir. 1923); Phillips v. Iola Portland Cement Co., 125 F. 593, 594-95 (8th Cir. 1922); Tillar v. Cole Motor Car Co., 246 F. 831, 831-32 (5th Cir. 1917), *cert. denied*, 247 U.S. 511 (1918). But in 1963 the Department of Justice challenged them as per se illegal in White Motor Co. v. United States, 372 U.S. 253 (1963). The Supreme Court declared, however, that "[w]e need to know more than we do about the actual impact of

principle that "departure from the rule of reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing."[51] It acknowledged the pro-competitiveness of nonprice restrictions that encourage dealers to provide services for products which could not sell otherwise.[52] The Court also recognized the reasonableness of terminating dealers who free ride on the pre-sale services of other intrabrand dealers.[53]

A free-rider is a distributor who avoids providing product services in order to discount the retail price, while benefiting from the services provided by other dealers selling the same product. For example, free riding occurs when a customer decides to purchase a product on the basis of product service and information provided by a full-service retailer, but then buys it from a free rider who sells the same product at a reduced price.[54] The danger of free riding is that the full-service distributor may discontinue its own product services. Since the full-service dealer cannot withstand being undercut in the intrabrand mar-

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these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classified as *per se* violations of the Sherman Act." *Id.* at 263 (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958)). At the trial level, the district court had accepted the Department's contention that such arrangements were per se illegal. United States v. White Motor Co., 194 F. Supp. 562, 570-88 (N.D. Ohio 1961), *rev'd*, 372 U.S. 253 (1963).

In United States v. Arnold, Schwinn & Co. 338 U.S. 365 (1967), the Court drew formalistic lines upholding nonprice restraints for consignments where manufacturers retained title to the goods, but declaring illegal those arrangements in which title passed to the dealer. Preservation of the reasonable standard in the former instance is supposed by some to result from regard for the *Colgate* doctrine since restraints are permitted where the manufacturer retains an ownership interest in the retail market. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 66-69 (1977) (White, J., concurring). The Court, though, may have also recognized a potential pro-competitiveness in nonprice restrictions, and may not have wanted to completely foreclose their use. *Id.* at 52-53. However, the *Schwinn* line drawing was largely perceived as too arbitrary and was overruled ten years later in *Sylvania. Id.* at 48 n.14. *See also* Posner, *Reflections, supra* note 8, at 3.

51. *Sylvania,* 433 U.S. at 58-59.

52. *Id.* at 52-55.

53. *Id.* at 55.

54. *See* Butler & Baysinger, *Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory,* 32 EMORY L.J. 1009, 1023-24 (1983); *Pul-eeze! Will Somebody Help Me?: Frustrated American Consumers Wonder Where the Service Went,* TIME, Feb. 2, 1987, at 48, 52-53.

Often the problem of free riding extends beyond pre-sale product services to post-sale product services. Many full-service retailers are contractually required to service all products of the brand, including those of the free riding outlet which does not maintain a service department. *See* Bork, *supra* note 8, at 446.

ket, it will reduce product services to bring its retail price down to levels competitive with the free rider. Eventually the absence of product services, assuming that they are appreciated by the customer, will harm the product's competitiveness in the interbrand market.[55] Consequently, the manufacturer wants to prevent free riding and maintain balance in the intrabrand market.[56] The reasonableness standard of nonprice restraints allows a manufacturer to terminate a dealer for free riding.[57]

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55. Kearl & Wood, *Economics and Antitrust Litigation*, 34 AMER. J. COMP. L. 291, 295-96 (Supp. 1986); T. OVERSTREET, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE, BUREAU OF ECONOMICS STAFF REPORT TO THE FEDERAL TRADE COMMISSION 49 (1983). Continual free riding on the goodwill of the trademark created by the service of other dealers will injure the product image. Bork, *supra* note 8, at 435-36. According to Judge Bork,

> [t]he member of a [retail] group has a special problem . . . . It may find that it is unable to recapture all of its expenditures in local sales effort because a neighboring member of the group undersells it. The interloper gets all the advantages of the first firm's expenditures without paying for them. It thus gets a free ride and this very fact may enable it to undersell profitably. The customer gets free information and advice. The point is not that such behavior is unfair but rather that by making the effort less profitable, it will decrease the amount of local sales effort members of the group are willing to do. To that extent the group becomes a less efficient marketer than a single fully-integrated firm of the same size.

Id.

56. Letter from Assistant Attorney General Baxter to William K. Daines of the American Retail Federation, *reprinted in* 14 ANTITRUST L. & ECON. REV. (No. 4) 14 (1983); Kwoka, *Antitrust Analysis and the 'Cooperating Core': It's the First 2 Market Shares that Count (II)*, 16 ANTITRUST L. & ECON. REV. (No. 1) 47, 69 (1984).

57. However, territorial restrictions are unlawful if they are an integral part of a resale price maintenance agreement. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 373 (1967); Copper Liquor, Inc. v. Adolph Coors, Co., 506 F.2d 934, 944 (5th Cir. 1975); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398, 403-05 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968).

But if price restraints are ancillary to a bona fide nonprice restraint imposed on a distributor which plausibly creates efficiencies, the arrangement will be analyzed according to the rule of reason. *See* Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1439-40 (7th Cir. 1986); Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883, 885-86 (1st Cir.), *cert. denied*, 439 U.S. 833 (1978). There is a conflict within the circuits as to whether the anti-competitive motive need only be the primary motive of the termination to be illegal per se, Zidell Explorations, Inc. v. Conval Int'l, Ltd., 719 F.2d 1465, 1470-71 (9th Cir. 1983), or whether it must be the sole motive, Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1200 n.13 (6th Cir. 1982), *cert. denied*, 466 U.S. 931 (1984). However, this dispute is resolved somewhat by the Supreme Court decision of Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 (1984), which calls for a requirement of positive evidence disproving the idea that the action constituted an independent business decision. *See infra* notes 68-70 and accompanying text.

The Supreme Court in *Sylvania* did not instruct the lower courts on how to apply the reasonable standard. The following cases propose various applications: Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 221 (D.C. Cir. 1986), *cert. denied*, 107 S.Ct. 880 (1987); General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d

The difference between *intra*brand and *inter*brand markets is important. By eliminating retailers or wholesalers that disrupt the distribution system through free riding, the manufacturer reduces the intensity of competition among its own dealers—the intrabrand market.[58] Critics of these nonprice restrictions contend that the reduced intensity causes an oligopolistic effect[59] within the intrabrand market whereby dealers increase their profit per unit and become less aggressive in making sales against intrabrand rivals.[60]

However, proponents of nonprice restraints maintain that these criticisms are rarely relevant to interbrand competition. Their reasoning is that vertical nonprice arrangements are dis-

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588, 596 (7th Cir. 1984), *cert. denied*, 50 U.S.L.W. 3400 (Dec. 7, 1987); Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560, 1568-69 (11th Cir. 1983); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982); Muenster Butane v. Stewart Co., 651 F.2d 292, 298 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1005 (5th Cir.), *cert. denied*, 454 U.S. 827 (1981); Eiberger v. Sony Corp. of Am., 622 F.2d 1068, 1081 (2d Cir. 1980); Cowley v. Braden Indus., 613 F.2d 751, 755 (9th Cir.), *cert. denied*, 446 U.S. 965 (1980); Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 130 n.5 (2d Cir.), *cert. denied*, 439 U.S. 946 (1978).

58. The interplay between intra- and interbrand markets was described by the Supreme Court in *Sylvania*:

> Interbrand competition is the competition among the manufacturers of the same generic product—television sets in this case—and is the primary concern of antitrust law. The extreme example of a deficiency of interbrand competition is monopoly, where there is only one manufacturer. In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer.
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> This degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

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

59. An oligopoly is a market configuration where a few players affect, but do not control, the market. It has been defined as a "form of imperfect competition which obtains when sellers are few in number and any one of them is of such size that an increase or decrease in his output will appreciably affect market price." S. Oppenheim, G. Weston, & J. McCarthy, Federal Antitrust Laws: Cases, Text, & Commentary 277 (4th ed. 1981) (quoting Wilcox, *Competition and Monopoly in American Industry,* TNEC Monograph No. 21 (1941).

60. Comanor, *Vertical Territorial and Customer Restrictions:* White Motor *and its Aftermath,* 81 Harv. L. Rev. 1419, 1422 (1968). According to Professoor Gerhart, nonprice competition increases sales only to the extent that consumers desire additional services. Gerhart, *The "Competitive Advantages" Explanation for Intrabrand Restraints: An Antitrust Analysis,* 1981 Duke L.J. 417, 431.

advantageous only if the manufacturer has significant market share or monopoly power such that the intrabrand market constitutes the interbrand market as well. It is conceded that if the intrabrand market constitutes a substantial portion of the interbrand market, less activity in one market would result in less activity in the other. But in a competitive industry, the reduced competition of the intrabrand market causes dealers to redirect their efforts toward the interbrand market. This channeling of competition from the intrabrand to the interbrand market is efficient because the interbrand market is where the product must ultimately fail or succeed.[61]

Some critics contend that nonprice restraints also decrease interbrand competition.[62] The argument is that nonprice restrictions encourage unnecessary product differentiation for the purpose of reducing substitutability. Product differentiation ostensibly allows retailers to charge a price above the market without reducing the volume of sales. However, the Supreme Court in *Sylvania* rejected this argument as "flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality, and services."[63] In sum, therefore, the Supreme Court's determination in *Sylvania* that nonprice restrictions should be examined under the reasonableness standard is premised on the economic reality that while nonprice restrictions may reduce intrabrand competition, they nonetheless encourage interbrand competition. Thus, the manufacturer's overall market position is improved and market efficiency is not lost.[64]

B. *Evidentiary and Analytic Problems Arising From the Price/Nonprice Dichotomy*

According to many commentators, the disparate treatment of price and nonprice restrictions causes two problems. First, an

61. Bock, *An Economist Appraises Vertical Restraints*, 30 ANTITRUST BULL. 117, 120-21 (1985); Bork, *Vertical Restraints:* Schwinn *Overruled*, 1977 SUP. CT. REV. 171, 180-81; Butler & Baysinger, *supra* note 55, at 1060-61; Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 140-53 (1984); Kearl & Wood, *supra* note 54, at 295-96; Posner, *The Next Step*, *supra* note 8, at 8-14.

62. Comanor, *supra* note 60, at 1422-33.

63. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 56 n.25; *see also* R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 291 (1978).

64. *See* Davis-Watkins Co. v. Service Merchandise Co., 686 F.2d 1190, 1196 (6th Cir. 1982), *cert. denied*, 466 U.S. 931 (1984).

evidentiary problem occurs because unlawful terminations to reduce intrabrand price competition cannot be easily distinguished from the lawful terminations of dealers that violate legitimate nonprice restraints. *Business Electronics'* distinction between price fixing and price stabilization was designed to resolve that problem. Second, an analytic problem occurs because price restraints are viewed as per se anti-competitive although they may be as beneficial to interbrand competition as nonprice restraints. The Fifth Circuit did not specifically respond to the analytic problem in *Business Electronics*, but *Business Electronics* may have the effect of resolving the problem in a practical sense.

1. *The evidentiary problem*

The crisp theoretical distinctions between price and nonprice restrictions, or terminations for price cutting and terminations for free riding, are not so clear in practice because a free rider typically cuts prices as well.[65] A free rider can offer discounted prices because it avoids the product services that other distributors are providing. Moreover, a competing dealer who is victimized by free riding will be primarily concerned with the price cutting.[66] Therefore, the legitimate termination of a free rider may be confused with concerted action to reduce price competition. If a court holds terminations of price cutters illegal per se on one hand, and judges terminations of free riders under the rule of reason on the other, it risks finding a per se violation in a legitimate and pro-competitive business decision. Since these two situations are easily confused, a jury has the impossible task of reading the manufacturer's mind to determine the real motive behind the termination. The danger is that the threat of damages (if a per se violation is found) will deter manufacturers from adopting legitimate nonprice restrictions, thereby causing an "irrational dislocation in the market."[67] In other words, the manufacturer may be compelled to retain a dis-

65. *See* Illinois Corporate Travel, Inc. v. American Airlines, Inc., 806 F.2d 722, 728 (7th Cir. 1986); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 706-07 (7th Cir.), *cert. denied,* 469 U.S. 1018 (1984); Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883, 885 (1st Cir.) *cert. denied,* 439 U.S. 933 (1978); Liebeler, *1983 Economic Review of Antitrust Developments: The Distinction Between Price and Nonprice Distribution Restrictions,* 31 UCLA L. REV. 384, 388-91 (1983).

66. Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1440 (7th Cir. 1986); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 744 (7th Cir. 1982).

67. Monsanto Co. v. Spray-Rite Serv. Cop., 465 U.S. 752, 764 (1984).

tributor who is actually harming the manufacturer's position in the interbrand market.

The Court recognized this problem in *Monsanto Co. v. Spray-Rite Service Corp.*[68] "[I]t 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."[69] But since the economic effect of price and nonprice agreements is often similar, a manufacturer's promotion of pro-competitive pre-sale services can be confused with anti-competitive price fixing. Therefore, the Court held that complaints of price cutting from other dealers are not in themselves conclusive of a conspiracy to reduce price competition. Rather, the plaintiff must 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.' "[70]

The Fourth, Sixth, Seventh and Eighth Circuits have used the *Monsanto* reasoning to reverse district court findings of per se illegality.[71] In these cases—all involving vertical restraints on

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68. *Id.*

69. *Id.* at 762.

70. *Id.* at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981)).

71. National Marine Elec. Distribs., Inc. v. Raytheon Co., 778 F.2d 190, 192-93 (4th Cir. 1985); Beach v. Viking Sewing Mach. Co., 784 F.2d 746, 750-51 (6th Cir. 1986); Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1440 (7th Cir. 1986); McCabe's Furniture, Inc. v. La-Z-Boy Chair Co., 798 F.2d 323, 330 (8th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3495 (U.S. Dec. 29, 1986)(No. 86-1101). The last two cases are discussed *infra* note 112.

Other cases since *Monsanto* requiring positive evidence of an anti-competitive conspiracy include Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 593-98 (1986); Illinois Corporate Travel, Inc. v. American Airlines, Inc., 806 F.2d 722, 726 (7th Cir. 1986)(The plaintiff must show that "the defendant acted in a way that, but for a hypothesis of joint action, would not be in its own interest."); Garment Dist., Inc. v. Belk Stores Servs., Inc., 799 F.2d 905, 908-11 (4th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3294 (U.S. Nov. 17, 1986)(No. 86-794); Park v. El Paso Bd. of Realtors, 764 F.2d 1053, 1060 (5th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986).

A refusal to deal is not probative of illegal conspiratorial restraint of trade if the manufacturer can demonstrate that the refusal was an independent business decision and was in furtherance of its marketing strategy. *See* Terry's Floor Fashions, Inc. v. Burlington Indus., Inc., 763 F.2d 604, 614 (4th Cir. 1985); Transource Int'l, Inc. v. Trinity Indus., Inc., 725 F.2d 274, 281 (5th Cir. 1984); Southway Theatres, Inc. v. Georgia Theatre Co., 672 F.2d 485, 494 (5th Cir. Unit B 1982); *accord El Paso Bd. of Realtors*, 764 F.2d at 1060.

This *Monsanto* standard has also been applied to cases not involving vertical price fixing. *E.g., Terry's Floor Fashions*, 763 F.2d at 612 n.14, 614 (finding no antitrust violadistribution—the courts concluded that the manufacturers could have been motivated as much by a desire to terminate free riders or promote nonprice restrictions as by a desire to fix prices when they terminated the plaintiff. Thus, the juries did not have sufficient evidence before them to confirm allegations that the manufacturers fixed prices.

Although purporting to follow *Monsanto*, *Business Electronics* did not resolve the evidentiary problem by making a factual determination that the manufacturer intended to eliminate free riding rather than fix prices. Instead the court accepted the jury's finding that an agreement to eliminate price competition existed. It did, however, make the legal determination that an agreement to terminate, by itself, was not per se illegal.[72]

2. *The analytic problem*

The current law is based upon the assumption that nonprice restrictions may be innocuous, but price restrictions are always harmful. However, many commentators contend that resale price maintenance may actually be beneficial.[73] Specifically, price maintenance may encourage product services more efficiently than nonprice restrictions. They argue that the *Sylvania* method of judging nonprice restrictions according to the rule of reason—because of their potential to encourage interbrand competition—should apply to vertically imposed price maintenance restrictions as well.[74] This concept was first explored by Lester Telser in his article, *Why Should Manufacturers Want Free Trade?*[75] Telser reasoned that manufacturers seldom impose minimum resale prices in order to provide dealers with monopoly profits because it is not in the manufacturer's interest. Rather, the manufacturer desires as much intrabrand price competition as is possible, at least until the interbrand market demands an emphasis on service instead.[76] To meet the service

tion in a manufacturer's instruction to one dealer not to sell the product to a competing dealer).

72. See *infra* notes 102-08 and accompanying text.

73. This is because price restrictions, or resale price maintenance, eliminate free riding by causing a retailer to recoup his investment in product services. *See, e.g.*, Bork, *supra* note 8, at 453-54; Hay, *supra* note 8, at 428; Posner, *The Next Step*, *supra* note 8, at 8-14; Posner, *Reflections*, *supra* note 8, at 2-10; Baker, *supra* note 8, at 1462 n.20.

74. Baker, *supra* note 8, at 1465-67; Bork, *supra* note 8, at 391-464; Posner, *Analysis*, *supra* note 8, at 292-93.

75. 3 J.L. & ECON. 86 (1960).

76. This thesis is demonstrated in Bork, *supra* note 8, at 397-405.

need, a manufacturer could set prices at a level which induces retailers to provide competitive product services. By fixing a price artificially above the market, retailers will offer services until their marginal costs of distribution rise to the fixed price.[77] Using sophisticated market analysis, prices could be set at a level where the price/service mix would make the product competitive in the interbrand market.[78] In an efficient market the retailer would find no advantage in not providing the services because, with prices set uniformly at a certain level, competition with its intrabrand rivals would depend solely upon the quality and quantity of services. Therefore, if this economic analysis is correct, resale price maintenance can eliminate free riding without choking competition.[79]

However, the Supreme Court in *Sylvania* justified the continued per se treatment of price maintenance restrictions by ar-

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77. Telser, *supra* note 75, at 89; *see also* Posner, *Reflections, supra* note 8, at 3-5; However, the services the supplier desires to promote are only those that the dealer would not normally provide itself. That is, services which are "specific to the commodity and unrelated to the retailers' methods of generally doing business. If . . . the retailers' general business methods are . . . [all that the manufacturer desires], then there is no need for the protection of resale price maintenance on the particular commodity to be sold jointly with these services." Telser, *supra* note 75, at 89.

78. T. OVERSTREET, *supra* note 55, at 50, 56-61; Bork, *supra* note 8, at 473. On the contrary, however, Professor Sullivan argues that "[a]ny single price the manufacturer may set will inevitably distort those fine variations which the market can make and will tend to hold the more efficient outlets, which would price at the lowest level, to a price at or near that which will be charged by the least efficient." L. SULLIVAN, *supra* note 5, § 134.

79. *See* R. POSNER, ANTITRUST LAW, 148-50 (1976); Bork, *supra* note 8, at 473; Easterbrook, *supra* note 61, at 147-49. According to Judge Bork, resale price maintenance is often a more effective incentive to provide the appropriate level of service than nonprice restrictions:

> When prices are fixed no purchaser is able to obtain the information and studies he wants from one seller and then purchases [sic] the identical product from another at a lower price. Each seller is, therefore, free to engage in the optimal amount of selling effort without fear that another seller of the same brand will enjoy a free ride at his expense. Where a reseller's price is maintained, he is forced to engage in other forms of competition in order to make a competitive return. Market division permits the seller to use an appropriate amount of local sales effort. Price fixing forces him to. Market division may be a superior technique where the appropriate degree of local sales effort varies from market to market and is best left to the seller's judgment. Price fixing may be superior where uniformity of sales effort is important or where the manufacturer believes itself a better judge of selling techniques than a significant fraction of its resellers. Price fixing is also likely to be preferable to market division in any situation where effective marketing requires thorough coverage of an area through numerous resellers rather than use of a single outlet.

Bork, *supra* note 8, at 454.

guing that they facilitate the formation of manufacturer cartels and that they encourage the spread of price restraints in other markets.[80] Some commentators fault this argument because manufacturer cartels are usually ineffective when retailers carry more than one manufacturers' line of goods. This is because a cartel by nature encourages "cheating"—when one participant secretly charges a lower price to have a competitive advantage. Dealers which carry goods from many suppliers in a cartel will order more goods from the cheater, thereby reducing the effectiveness of the cartel without alerting its members to the cartel's demise.[81] Moreover, to the extent that price restrictions do facilitate manufacturer-level cartels, nonprice restrictions can be equally anti-competitive and effective in sustaining them. A cheating member of a cartel which imposes nonprice restrictions cannot claim that increased intrabrand activity is responsible for a rise in sales volume.[82]

The concern that price maintenance restrictions in one intrabrand market will lead to their use in other markets implies that they are anti-competitive. Indeed, some commentators believe that price maintenance restrictions serve only to protect marginal dealers from competition, that they have the effect of imposing barriers to market entry, and that they delay the introduction of innovative and more efficient distribution systems.[83] Moreover, the research of these theorists indicates that "sales volume per retail outlet is systematically lower under resale price maintenance."[84] However, proponents of price maintenance contend that this criticism is valid only if price maintenance restrictions impede interbrand competition. While this would occur if service competition did not increase sales, or if the restraints were designed to save retailers from intrabrand competition, impeding intrabrand competition is generally not

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80. Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36, 51 n.18 (1977). In addition to the sources cited, see Pitofsky, *The* Sylvania *Case: Antitrust Analysis of Non-Price Vertical Restraints,* 78 COLUM. L. REV. 1, 15-16 (1978); Telser, *supra* note 75, at 96-105; Note, *The Procrustean Approach Remains:* Monsanto Co. v. Spray-Rite Service Corp., 10 DEL. J. CORP. L. 733, 745-47 (1985).

81. Kearl & Wood, *supra* note 55, at 295; Posner, *Reflections, supra* note 8, at 7.

82. Kearl & Wood, *supra* note 55, at 295; Posner, *Reflections, supra* note 8, at 7-8.

83. Phillips & Mahoney, *Unreasonable Rules and Rules of Reason: Economic Aspects of Vertical Price-Fixing,* 30 ANTITRUST BULL. 99, 112-13 (1985).

84. ABA, MONOGRAPH No.2, *supra* note 3, at 80 (quoting *1975 Hearings on S. 408 before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee,* 94th Cong., 1st Sess., 176 (1975)).

in the manufacturer's interest. Rather, the manufacturer profits from an intrabrand market vigorous enough to affect the interbrand market. If the interbrand market is itself competitive—meaning that the market is effectively contestable and competition prevails at all stages of production and distribution—intrabrand markets with price restraints must enhance interbrand competition; otherwise, manufacturers will be injured from them.[85] In sum, these economists believe that where a vari-

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85. According to Professor Bock,

> competition is a continuing search for survival by firms seeking to find more efficient ways to meet shifting and variegated consumer needs; thus, all vertical arrangements between a single manufacturer and those reselling his product are seen as ways of competing that would not exist if the manufacturer did not believe they would increase his profit by increasing his efficiency, as well as the profit and efficiency of his distributors and/or dealers—and, therefore, in the end, achieve proconsumer goals.

Bock, *supra* note 61, at 120-21.

86. Phillips & Mahoney, *supra* note 83, at 112-15.

However, resale price maintenance is inappropriate when goods are fungible and highly substitutable. In these instances, consumer preference is based more on price and personal experience than on retailer service. Therefore, manufacturers will realize little advantage in implementing price restrictions or restricted distribution of any kind. According to Judge Easterbrook,

> [o]nly a small minority of manufacturers used RPM when it was lawful between 1919 and 1975. Only a small minority of manufacturers use any form of restricted dealing today. Most products can be sold without special services or information. S.S. Kresge (the old K-Mart) flourished during the days of the manufacturer's greatest freedom. It flourished because discount stores offer a combination of price and service that many customers value . . . . Nothing in restricted dealing threatens the ability of consumers to find low prices.

Easterbrook, *supra* note 61, at 152-53.

Some commentators fault resale price maintenance with depriving consumers of a low-cost alternative:

> If consumers flock to the low-margin discount houses and shun the small, high margin shops, they must do so because that is what they prefer. To prevent large retailers from pursuing a low-margin strategy . . . is to frustrate the adaptation of distribution channels to meaningful changes in consumer wants and to encourage the perpetuation of obsolete, inefficient channels . . . .
> Moreover, the widespread adoption of resale price maintenance tends to deprive consumers of a choice between buying on the basis of service and buying at the lowest possible price. The latter alternative is eliminated unless a substantial segment of the output in each industry is not fair-traded.

F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 592 (2d ed. 1980). However, this view ignores the vital point that the manufacturer's interest is in providing the consumer a choice, and if service is not desired then restraints on distribution will not be implemented. Active interbrand competition will ensure that consumers have choice. Along these lines, moreover, the key to interbrand competition is to create product differentiation among product, price, and service. R. BORK, *supra* note 63, at 291. Price restrictions can ensure that the manufacturer's distribution strategy prevails over the short-sighted motives of the discount retailers. According to Judge Posner, if consumers do not choose a product for its mix of services, they will choose a different brand ety of firms compete in the market, where the product is differentiated, and where differences among firms beyond price (e.g., product services) are valued by consumers, a distribution restraint affecting one intrabrand market will increase the choice available to customers and enhance overall competition.[86] This adds to consumer welfare.[87]

There is good reason to anticipate that the Supreme Court will adopt this economic analysis in judging vertical restraints. For instance, in 1984 the Solicitor General filed an amicus brief in *Monsanto* petitioning the Court to overturn the *Dr. Miles* prohibition of price restraints. The brief argued that "[t]here is no sound basis for assuming . . . that resale price maintenance is so invariably anticompetitive as to justify per se condemnation."[88] According to the Solicitor General, "the logic of *Sylvania* compels the conclusion that resale price maintenance—like other vertical restrictions—is unsuitable for per se treatment."[89] (After the brief was filed Congress amended an appropriations bill for the Department of Justice prohibiting it from engaging in any activity "the purpose of which is to overturn or alter the per se prohibition of resale price maintenance in effect under the Federal antitrust laws.")[90] The Supreme Court declined to reach that issue because it was not germane to the case at hand.[91] However, following *Monsanto* the Court invited the Solicitor General to file a brief in another case discussing whether "the rule of per se illegality still applies to vertical price fixing agreements."[92] The Solicitor General did not believe the case pending

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with a different mix of services or a brand with no services at all. R. POSNER, *supra* note 79, at 150.

87. It will undoubtedly worry some people that a policy of toleration toward terminations of price cutting dealers will open the gates to monopolies and cartels which will he harmful to consumer welfare. However, this assumes that price related terminations manifest a preponderant anti-competitive effect. In fact, a manufacturer gains nothing from reducing intrabrand competition, unless by so doing it redirects emphasis from price to service. Therefore, it may be a healthy change in antitrust law to presume some pro-competitive rationale in manufacturer conduct.

For a contrary view, see Hovenkamp, *supra* note 8, who attacks the Chicago School's preoccupation with allocative efficiency as the sole criteria for antitrust enforcement.

88. Brief for United States as Amicus Curiae at 6, Monsanto Co. v. Spray-Rite Service Corp., 684 F.2d 1228 (1982) (82-914).

89. *Id.* at 19.

90. Pub. L. No. 98-166, § 510, 97 Stat. 1102 (1983).

91. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 n.7 (1984).

92. Lewis Serv. Center, Inc. v. Mack Trucks, Inc., 466 U.S. 902 (1984). The question was posed in Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit, Lewis Service Center, Inc. v. Mack Trucks, Inc., 714 F.2d 842 (8th

raised that issue, and the Court denied certiorari.[93] Nevertheless, these events indicate the Supreme Court's willingness to review the per se rules of price restraints.[94]

C. *Proposed Solutions to the Evidentiary and Analytic Problems*

Some commentators advocate dismantling the price/nonprice dichotomy in an effort to resolve the evidentiary and analytic problems which arise. They propose shifting to a per se or presumed *legality* toward purely vertical restraints on distribution.[95] Assuming that manufacturers will impose vertical restraints only to make their product more competitive on the interbrand market, these commentators conclude that such restraints should be presumed competitive. There would be no danger that price restraints would cause cartelization because horizontal restrictions would remain illegal per se. The theory that manufacturers impose price restraints only to enhance the competitiveness of their product is supported by the fact that only one federal appellate decision since *Sylvania* has affirmed a

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Cir. 1983) (83-1273).

93. Lewis Serv. Center v. Mack Trucks, Inc., 467 U.S. 1226 (1984). For the Solicitor's views, see Brief for the United States as Amicus Curiae, Lewis Service Center, Inc. v. Mack Trucks, Inc., 714 F.2d 842 (8th Cir. 1983) (83-1273).

94. In subsequent decisions, however, the court has reaffirmed the continuing vitality of the per se rule for price restrictions. *See* California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, 102-03 (1980).

In the meantime, though, the conflict between the Reagan Department of Justice and Congress has intensified. In January 1985 the Department released its Vertical Restraint Guidelines. UNITED STATES DEPARTMENT OF JUSTICE, VERTICAL RESTRAINT GUIDELINES, *reprinted in,* 48 ANTITRUST & TRADE REG. REP. (BNA) (Special supplement 1985). They provide for a two step rule of reason analysis in which a "quick look" is first taken by the court or administrative agency to determine whether the challenged restraint may harm competition. If the restraint may harm competition, a more in-depth analysis, or "structured rule of reason" is undertaken. *Id.* at 3-4. The "quick look" is designed to expedite litigation by dismissing those cases in which the restraining firm has less than a ten percent market share. *Id.* at 7-9. For the in-depth analysis, though, the ease of entry and concentration levels are considered, with the help of an index prepared to determine whether the markets are concentrated. *Id.* at 9-10. The guidelines apply primarily to customer and territorial restrictions, and to exclusive dealing arrangements, but not to resale price maintenance. *Id.* at 3-4.

However, Congress disapproved the guidelines and expressed in the Department of Justice's appropriations bill its view that they "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." Pub. L. No. 99-190, 99 Stat. 1136 (1985).

95. *See, e.g.,* Hay, *supra* note 8, at 436-40; Posner, *The Next Step, supra* note 8, at 22-26.

finding that a purely vertical restriction was anti-competitive.[96] (Other than that decision, anti-competitive conduct was found only where the restraints on distribution were horizontal.) Therefore, the per se approach serves only to prevent efficient distributing methods. According to Judge Posner:

> Given the absence of either theoretical or empirical grounds for condemning purely vertical restrictions as anticompetitive, to declare vertical restrictions in distribution legal per se would serve both to lighten the burden on the courts and to lift a cloud of debilitating doubt from practices that are usually and perhaps always procompetitive.[97]

A second proposal is to judge all vertical restraints, including price restraints, under the rule of reason.[98] This approach is less dramatic because there would be no presumption that vertical restrictions are either pro-competitive or anticompetitive. Moreover, this idea would eliminate the evidentiary problem with the price/nonprice dichotomy, and would extend the *Sylvania* analysis to its logical end.

A third approach consists of "structural analysis."[99] To determine whether to evaluate a price restraint under the rule of reason, the court would consider the manufacturer's market share, the concentration of competitors, the nature of the product and the method of distribution.

However, with the exception of the third approach, these alternative approaches are not currently in use because only the Supreme Court can sanction their application.[100] Lower courts may remedy the evidentiary and analytic problems solely by working within the *Dr. Miles* and *Sylvania* framework.[101] The Fifth Circuit believed that it found a solution within this framework.

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96. The case was Eiberger v. Sony Corp. of Am., 622 F.2d 1068 (2d Cir. 1980). Faruki, *The Defense of Terminated Dealer Litigation: A Survey of Legal and Strategic Considerations*, 46 OHIO ST. L.J. 925, 956 (1985). Posner maintains that the restraint in *Eiberger* was not vertical, but horizontal, as between the distributors. Posner, *The Next Step, supra* note 8, at 22.

97. Posner, *The Next Step, supra* note 8, at 23.

98. Baker, *supra* note 8, at 1520; Hay, *supra* note 8, at 440-41.

99. Hay, *supra* note 8, at 441-44.

100. Some lower courts have begun to examine the supplier's position within the interbrand market in deciding whether to impose per se liability. *See, e.g.*, Illinois Corporate Travel, Inc. v. American Airlines, 806 F.2d 722 (7th Cir. 1986); Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1435 (7th Cir. 1986).

101. Baker, *supra* note 8, at 1488.

D. *The* Business Electronics *Decision*

The Fifth Circuit held that Sharp's termination of BEC for price cutting was not illegal per se. Significantly the court did not reach this result by reversing the jury finding[102] or by denying that the jury had sufficient evidence to support its decision.[103] Nor did it apply the rule of reason to price restrictions. Rather, the court took the novel approach of drawing new lines to divide reasonable from per se illegal vertical restrictions. The *Business Electronics* court declared that only explicit price fixing agreements were illegal per se. All other restrictions, including terminations of retailers for price cutting in the absence of an explicit price agreement, may be reasonable even if the ensuing decrease in intrabrand competition facilitates a rise in price.[104]

To understand the dynamics of *Business Electronics*, it is helpful to conceive of the various vertical restraints placed lineally in a continuum.[105] At one extreme of the continuum stands the most pro-competitive vertical nonprice restriction, such as a product servicing requirement. Other restrictions are placed sequentially, each more anti-competitive than the one preceding it, until there stands at the other extreme the most pernicious type of vertical restriction—an explicit price fixing conspiracy. Following the reasoning that all agreements designed to influence price are illegal per se, courts have drawn the line separating reasonable restraints from illegal restraints between those directed at free riding and those directed at price cutting. The *Business Electronics* court, however, drew the lines on the basis of whether a price agreement exists or develops between the manufacturer and the nonterminated distributor. The result is a

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102. The court stated:

> There was evidence that, even before Hartwell became a dealer, Sharp sought BEC's adherence to the suggested retail price list. BEC produced evidence tending to show that it was not "free riding" and that its sales performance was equal to Hartwell's. The logical inferences from such evidence, if drawn by the jury, could support a finding that BEC's termination was not due to the reasons Sharp suggests.

Business Elecs. Corp. v. Sharp Elecs. Corp., 780 F.2d 1212, 1219 (5th Cir. 1986), *cert. granted,* 107 S.Ct. 3182 (1987).

103. *See supra* notes 68-72 and accompanying text.

104. 780 F.2d at 1216, 1218.

105. This continuum, or construct, is made within the *Sylvania* framework so there exists some vertical restrictions that are pernicious and that should be illegal per se. Of course, the economic analysis justifying resale price maintenance does not recognize any anti-competitiveness of vertical restraints. *See supra* notes 73-87 and accompanying text.

partial dissolution of the price/nonprice dichotomy. The termination of a price cutter where no agreement on price exists is judged under the rule of reason, rather than under per se illegality.

The *Business Electronics* court believed that its approach resolved the evidentiary problem of whether a termination is motivated by price or nonprice considerations.[106] It may also eliminate the concern that uncertain legal distinctions between price cutting and free riding will result in irrational market dislocations. As the court declared, "the manufacturer which desires to terminate a price cutter because of its free riding will be deterred from this legitimate action because it is indistinguishable, except perhaps to a mind reader, from [the] termination of a price cutter because of its price cutting."[107] By applying the rule of reason to all restraints short of explicit price fixing, there will be less opportunity for confusing valid nonprice terminations with illegal restraints of other sorts. The rule of reason requires a court to evaluate a restraint's impact on competition. Therefore, the actual purpose of the restraint can be revealed and the evidentiary problem eliminated.

Although the court's distinction between price fixing and price stabilization does not change the basis of the analytic problem (because even under *Business Electronics* resale price maintenance remains illegal per se regardless of its effect on competition), the holding may help resolve that problem in a practical sense. Strengthening the manufacturer's legal position by judging price stabilizing restrictions under the reasonableness standard may discourage distributors from free riding. Since price cutting creates a presumption of free riding in those situations where price cutting would be impossible without neglecting product service commitments, the would-be free rider might be discouraged, knowing that a suit challenging its termination will be judged according to the rule of reason. While discounting dealers could still successfully challenge anti-competitive terminations under the reasonableness standard,[108] trying cases under that standard often presents a financial hardship because of the

106. 780 F.2d at 1217-18.

107. *Id.* at 1218.

108. This supposition, of course, does not apply under the "Chicago" approach which states that resale price maintenance is not anti-competitive because it would not be in the manufacturer's interest to unnecessarily limit competition. *See supra* notes 73-87 and accompanying text.

difficulty in proving economic impact. This may deter distributors from even risking disruptive retail practices. In short, with the law on the side of the manufacturer, dealers will be reluctant to free ride in order to cut prices.

V. *Analysis of* Business Electronics

Depending on the Supreme Court's disposition of *Business Electronics,* the case may have a far-reaching impact. The Fifth Circuit's holding that price stabilization is not illegal per se has two positive results. First, it departs somewhat from the unjustifiable presumption that vertical price restraints are anti-competitive. Instead, the analysis is based upon the notion that the manufacturer and consumer interests coincide in the vertical sphere—that manufacture-imposed vertical restraints are pro-competitive. In this sense the decision will increase consumer welfare.[109]

Second, the decision brings the law closer to the Supreme Court's enunciated policy of judging restrictions according to their economic effect. Recall that the Court in *Sylvania* stated that vertical restraints on distribution should be judged by "demonstrable economic effect rather than . . . upon formalistic line drawing."[110] Since vertical price stabilization is not a restraint without "any redeeming virtue,"[111] the per se rule should not be applied.

Significantly, other circuit courts are recognizing the result in *Business Electronics.* Within months of the decision, three circuit courts cited the case with approval, albeit in cases which are factually distinguishable from *Business Electronics.*[112]

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109. *See, e.g.,* Zidell Exploration, Inc. v. Conval Int'l, Ltd., 719 F.2d 1465, 1471 (9th Cir. 1983); Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348, 1356-57 (9th Cir. 1982); Posner, *Reflections, supra* note 8, at 17-20.

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

111. Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

112. For example, the Seventh Circuit in Morrison v. Murray Biscuit Co., 797 F.2d 1430 (7th Cir. 1986), concerning discounting and a violation of dealer territory limitations, held that where terminations could be justified as much by price as by nonprice considerations, the rule of reason should be applied. The court, Judge Posner writing, declared "[w]e thus agree with the Fifth Circuit in *Business Electronics Corp. v. Sharp Electronics Corp.* and the Tenth Circuit in *Westman,* that the mere fact that the dealer may be motivated by antipathy to price competition is irrelevant and that the contrary suggestion . . . is unsound." *Id.* at 1440 (citation omitted).

Another Seventh Circuit case, Illinois Corporate Travel, Inc. v. American Airlines, Inc., 806 F.2d 722 (7th Cir. 1986), arose where American Airlines would not permit a travel agent to issue tickets for its planes because the agent advertised discount prices

In any event, the Supreme Court should not simply affirm *Business Electronics* because the decision violates precedent. Through decades of antitrust case law since *Dr. Miles* no distinction has been recognized between agreements which directly influence prices and agreements which influence prices only indirectly.[113] Moreover, the potentially beneficial impact of price agreements has never been considered a mediating factor. In fact, the minimum price scheme at issue in *Dr. Miles* was designed to promote interbrand competition by protecting the service-oriented druggists.[114] Nevertheless, in that case the Supreme Court held that the "destruction of competition and the fixing of prices"[115] violated the law. Therefore, the distinction relied on in *Business Electronics* is a false one. It is really only a clever way of dismantling the *Dr. Miles* rule without overruling higher authority.

In addition, the Supreme Court should not simply affirm

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contrary to a clause prohibiting advertising in its contract. The court, through Judge Easterbrook, held that there was insufficient evidence of a conspiracy between American and the competing agents. "Concerns about free-riding by discount travel agents . . . may have led American to adopt its policy no matter what the agents thought or wanted . . . . Evidence that American discussed both price and [the plaintiffs] with other agents does not support an inference of conspiracy." *Id.* at 726. The judge continued, "[w]hen a new vertical restraint comes before the court, then, the appropriate response is not automatic condemnation but consideration whether the practice has a potential for harm (which includes an inquiry into market power) and, if there is such a potential, whether there are also potential benefits for consumers." *Id.* at 728. Judge Easterbrook went on to imply, in dicta, that all vertical restraints, including price restraints, should be judged under rule of reason. *Id.* The concurring opinion criticized this view as "depart[ing] from long-standing precedent." *Id.* at 731 (Flaum, J., concurring).

Likewise, the Eighth Circuit in McCabe's Furniture, Inc. v. La-Z-Boy Chair Co., 798 F.2d 323 (8th Cir. 1986), *petition for cert. filed,* 55 U.S.L.W. 3495 (U.S. Dec. 29, 1986) (No. 86-1101), where a discounting distributor was terminated for reflecting an image of poor quality, cited *Business Electronics* for the following proposition: "[A]s post-*Monsanto* authority recognizes, for a terminated dealer to prevail on its per se claim, the evidence must be sufficient for the jury to determine not merely that the manufacturer and nonterminated dealer conspired, but that they conspired to maintain resale prices." *Id.* at 329.

The Tenth Circuit adopted the *Business Electronics* reasoning in Westman Comm'n Co. v. Hobart Int'l Inc., 796 F.2d 1216 (10th Cir. 1986), *petition for cert. filed,* 55 U.S.L.W. 3259 (U.S. Sept. 22, 1986) (No. 86-484), where a franchise application was refused at the behest of a competing distributor, the court reversed a finding of per se liability. "Since the record reveals not the slightest hint of price maintenance or price fixing, Hobart's refusal to deal cannot be illegal per se. Of course, if there were allegations of retail price maintenance, price fixing, or tying arrangements, our analysis would be quite different." *Id.* at 1224.

113. *See supra* notes 19-43 and accompanying text.

114. *See supra* notes 19-20 and accompanying text.

115. Dr. Miles Co. v. John D. Park & Sons Co., 220 U.S. 373, 408 (1911).

Business Electronics because the decision does not adequately resolve the analytic problem since resale price maintenance remains illegal per se.[116] Rather, the Supreme Court should overturn the *Dr. Miles* principle, as the petition for Sharp requests.[117] Reversal of the *Dr. Miles* decision would legitimize the Fifth Circuit's analysis and allow all vertical restraints on distribution to be analyzed according to economic impact.

VI. Conclusion

As the Supreme Court reviews *Business Electronics*, there is good reason to expect the Court to affirm the decision even though it contravenes prior case law. The Court also may take the opportunity to overturn the *Dr. Miles* principle. The Court's policy of judging restraints according to economic impact, its concern with the evidentiary and analytic problems, and its past efforts to re-examine the law of vertical restrictions all foreshadow a reorganization of the legal status of vertical restraints on distribution.

Scott G. Crowley

116. *See supra* note 102-05 and accompanying text.

117. Cross-Petition For Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212 (5th Cir. 1986) (85-1910).

The question presented by Sharp in its petition is "[w]hether vertical price fixing agreements should be evaluated under the rule of reason, rather than being deemed *per se* illegal under § 1 of the Sherman Act." *Id.* at i. Sharp's cross petition was an alternative response to its initial brief opposing BEC's petition for certiorari. The cross petition concludes "if the Court grants the petition of BEC, it should also grant this cross-petition to resolve whether it should continue to apply the *per se* rule to vertical price restraints." *Id.* at 10.

The strategy employed by Sharp seems to implicitly acknowledge the fact that the distinctions drawn by the Fifth Circuit are only tenuously based on precedent, and that to have its lower court victory affirmed by the Supreme Court the entire treatment of price restraints since *Dr. Miles* will have to be reexamined.