Notre Dame Law Review

Volume 74 | Issue 1 Article 3

10-1-1998

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THE *ALBRECHT* RULE AFTER *KHAN*: DEATH BECOMES HER

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I. INTRODUCTION

In 1968, the Supreme Court made a mistake. It held in *Albrecht v. Herald Co.*[1] that an agreement between a supplier and its dealer setting the maximum price the dealer will charge for the supplier's products is a per se violation of the antitrust laws. The decision was at odds with the purpose of the law, for maximum resale price fixing benefits consumers by preventing dealers from exploiting market power. Suppliers do not adopt the practice out of benevolence for consumers, of course. They profit from it. This is one of those happy economic instances in which the interests of suppliers and consumers are aligned, and are opposed to the interests of dealers. The Court should have sat back and allowed the market to work. The decision to intervene was a testament to the confusion attending the Court's perception of antitrust goals during that era, as well as to the Court's failure to appreciate the economic function of the practice.

Twenty-nine years later, the Court corrected its mistake. In *State Oil Co. v. Khan*,[2] the Court repudiated *Albrecht*, holding that vertical maximum price fixing is not illegal per se. Antitrust doctrine had evolved significantly during the interim. The Court had, for example, revised its approach to nonprice distributional restraints, holding that they are no longer illegal per se.[3] *Albrecht* became an anachronism. *Khan* reflects both a sharpened focus on what the law is about and an increased level of economic sophistication. In particular, scholars had

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1 390 U.S. 145 (1968).

2 118 S. Ct. 275 (1997).

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

bombarded *Albrecht* relentlessly, and the Court decided the time had come to strike the flag. Better late than never.

Albrecht was an insidious case. Not only did it force suppliers to devise costly alternatives to vertical maximum price fixing that served the same purpose, it weakened the antitrust injury doctrine. That doctrine requires a private plaintiff to demonstrate an injury related to the inefficiency caused by an unlawful practice. Maximum resale price agreements are not anticompetitive, and so both lower courts and the Supreme Court struggled to reconcile the substantive *Albrecht* rule with the doctrine of antitrust injury. Their attempts never fully succeeded, and the antitrust injury doctrine became less coherent as a result. By overruling *Albrecht*, the Court freed the doctrine from the stress of an inconsistent substantive rule.

Khan, however, is not a complete success. The Court pointedly refused to hold that maximum vertical price fixing is legal per se, deciding instead that it is subject to the rule of reason. Applying the rule of reason to a practice seems innocuous enough, even enlightened. Who could object to condemning a practice when it has unreasonable effects? But the Court offers no guidance on how to conduct an inquiry into the reasonableness of the practice, and if maximum resale price agreements predictably have no anticompetitive effects, the inquiry is a waste of effort. Worse, because courts are fallible, welfare-increasing instances of the practice can be deterred. Besides, the possibility of illegality—however remote—means that the tension between the substantive rule and the antitrust injury doctrine is not wholly resolved.

In the next section, we trace the doctrinal history of the *Albrecht* rule. We then describe the *Khan* decision. In Part IV, we offer an economic analysis of vertical maximum price fixing, addressing in turn the function of the practice and the possibility that it could be used by a supplier to exploit monopsony power. We discuss the implications of *Khan* in Part V, highlighting the strengths and weaknesses of the opinion and concluding that it does not presage a sea change in other antitrust doctrines. A brief conclusion follows.

II. EVOLUTION OF THE DOCTRINE

A. Albrecht *and Its Foundation*

In *Khan*, the Court repudiated the rule that maximum resale price restrictions imposed by a supplier on its distributors through some kind of an agreement is illegal per se. That rule was laid down in *Albrecht*,[4] where a newspaper publisher sold its papers to independent, home-delivery carriers, who were expected to resell them at prices no higher than those advertised by the defendant publisher. Carriers were given routes that were exclusive as long as they adhered to the suggested maximum resale prices, which the publisher advertised as being available to subscribers. Albrecht, the plaintiff carrier, complied with the price ceiling for a time, but when he raised his prices, the publisher complained to him, offered to sell papers directly to his customers at the lower, suggested resale prices, and hired a solicitor to offer those customers direct home delivery. It also gave Albrecht's route to another carrier on a temporary basis, informing him that he would lose the route if his prices exceeded the specified maximum or perhaps if Albrecht conformed to the price cap. Albrecht lost customers as a result and sued the publisher under Section 1 of the Sherman Act.[5] Over stinging dissents by Justices Harlan and Stewart, the Court held that Albrecht was entitled to judgment as a matter of law.[6]

One significant aspect of *Albrecht* is the Court's analysis of agreement for Section 1 purposes. Relying upon *United States v. Parke, Davis & Co.*,[7] the Court had no trouble concluding that a combination existed between the publisher, the solicitor, and the replacement carrier.[8] The Court opined, moreover, that Albrecht could have successfully asserted a combination between the publisher and himself, at least as of the day he unwillingly complied with the suggested price, and one between the publisher and other carriers who followed the pricing guideline.[9] The Court even suggested that Albrecht might have successfully alleged a combination between the publisher and Albrecht's customers.[10] For present purposes, what is interesting about this analysis is that, according to the Court, the agreement necessary to condemn a vertical maximum price restraint under Section 1 need not take place between the supplier and a dealer whose pricing decisions are constrained. Even the agreement between the publisher

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4 390 U.S. 145 (1968).

5 15 U.S.C. § 1 (1994).

6 For an economic analysis consistent with the views of Justices Harlan and Stewart, see Roger D. Blair & David L. Kaserman, *The* Albrecht *Rule and Consumer Welfare: An Economic Analysis*, 33 FLA. L. REV. 461 (1981).

7 362 U.S. 29 (1960) (holding that a manufacturer combines with its wholesalers when it announces suggested retail prices and refuses to sell to wholesalers who sell to non-complying retailers and that it combines with retailers when it takes steps to persuade retailers to comply with the suggested prices).

8 *See Albrecht*, 390 U.S. at 149–50.

9 *See id.* at 150 n.6.

10 *See id.*

and the solicitor, for example, would have triggered the application of Section 1.

Our primary concern, however, is the second aspect of the opinion—that a vertical maximum price restraint is per se illegal. The Court alluded to several, perhaps four, economic effects of such a restraint in support of its conclusion: (1) maximum resale price restraints may "severely intrude upon the ability of buyers to compete" by limiting the dealers' pricing freedom;[11] (2) the resale price "may be fixed too low" for the dealer to provide all of the services for which consumers are willing to pay;[12] (3) maximum resale price fixing "may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice competition;"[13] and (4) if dealers nearly always charge the fixed maximum price, "the scheme tends to acquire all the attributes of an arrangement fixing minimum prices."[14] The Court went on to reject the defense that the price restraint was justified because the publisher had conferred exclusive distribution territories on its carriers, so that a price cap was necessary to prevent the carriers from exploiting their monopoly power.[15] The Court was skeptical that the vertical territo-

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11 *Id.* at 152. The Court cited this consequence first, and its observation in full was that "schemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market." *Id.* The best interpretation of this passage is that the Court did not intend to describe a separate, adverse economic effect of the practice at issue, but rather to summarize the detailed effects that follow. Implicitly, the Court seemed to so construe the passage in *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 336–37 (1990), where the Court did not allude to this asserted consequence in a list of the adverse effects identified in *Albrecht*. But in *State Oil Co. v. Khan*, 118 S. Ct. 275, 282 (1997), the Supreme Court treated the adverse impact on "dealer freedom" as a separate purported justification, so for clarity we do so here.

The passage does highlight an ambiguity in the *Albrecht* Court's analysis. Thus, the Court might have been suggesting that consumer welfare is the sole purpose of the antitrust laws and that restraining dealers is significant only because it may affect the interests of consumers. Or the Court might have intended to imply that protecting dealers is an independent purpose of the antitrust laws. *See infra* notes 87–89 and accompanying text. The fact that the Court counts channeling sales through large dealers as an adverse effect of the practice lends some support for the latter interpretation, for the suggestion seems to imply that the antitrust laws are offended when a supplier acts to confine distribution to the most efficient dealers when other, smaller dealers, though not consumers, are injured as a result. Protecting inefficient dealers obviously comes at the expense of consumers who consequently pay higher prices.

12 *Albrecht*, 390 U.S. at 152–53.

13 *Id.* at 153.

14 *Id.*

15 *See id.*

rial restrictions were valid and concluded that, if an otherwise illegal price restraint is necessary to blunt the "pernicious consequences" of the nonprice restraint, the whole scheme is illegal.[16]

We explain below that the effects specified by the Court do not support condemnation of vertical maximum resale price fixing, much less per se condemnation.[17] Here, however, we are interested in exploring the precedential basis for the Court's economically curious conclusion. One might have expected the Court to rely on *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[18] where the Court had held that vertical minimum resale price fixing is illegal per se. After all, the Court reasoned that a vertical maximum resale price agreement is anticompetitive in part because it may "acquire all the attributes of an arrangement fixing minimum prices,"[19] and citing at that point the seminal case condemning the referenced practice seems natural. In addition, vertical minimum and maximum price fixing bear some superficial resemblance. Yet the Court never mentioned the case, and the likely reason is that, in responding to Justice Harlan, the Court was forced to repudiate the logic of *Dr. Miles*. The Court in that case condemned vertical minimum price restraints partly on the ground that their effects are indistinguishable from those of horizontal price fixing by dealers, which is clearly "injurious to the public interest" and therefore illegal.[20] In other words, "the advantage of established retail

16 *Albrecht*, 390 U.S. at 154. Justice Harlan countered that exclusive territories "are neither always unlawful nor have they been demonstrated to be unlawful in this case." *Id.* at 166 (Harlan, J., dissenting). He argued that "rough territorial exclusivity" was likely efficient given the cost characteristics of newspaper distribution. *Id.* (Harlan, J., dissenting). He apparently thought that, as a result, either a single dealer would have a monopoly in a given territory and would price as a monopolist. Or "a relatively small number of competing distributors" would serve a given area, and they would price legally though non-competitively as oligopolists. *Id.* at 166–67 (Harlan, J., dissenting). (Whether Justice Harlan's prediction about the behavior of oligopolists comports with economic theory is a separate matter. *See generally* John E. Lopatka, *Solving the Oligopoly Problem: Turner's Try*, 41 ANTITRUST BULL. 843 (1996) (surveying various theories). Either way, the publisher's imposition of maximum resale price restrictions served the interest of "the public" and was therefore lawful. *See Albrecht*, 390 U.S. at 165 (Harlan, J., dissenting). Similarly, Justice Stewart reasoned that the granting of exclusive territories "was a perfectly permissible practice" and that the maximum resale price restriction was therefore lawful because it protected "householders . . . from the petitioner's monopoly position." *Id.* at 168–69 (Stewart, J., dissenting).

17 *See infra* notes 87–92 and accompanying text.

18 220 U.S. 373 (1911).

19 *Albrecht*, 390 U.S. at 153.

20 *Dr. Miles*, 220 U.S. at 408.

prices primarily concerns the dealers," not the manufacturer.[21] Justice Harlan argued in *Albrecht* that, whereas vertical minimum price fixing serves the interests of dealers, vertical maximum price fixing benefits the supplier and consumers.[22] In response, the Court offered a rather eloquent recitation of the special services theory of resale price maintenance, explaining that vertical minimum price fixing may indeed benefit a manufacturer and consumers by inducing the provision of point-of-sale services by dealers.[23] Of course, it is a mystery why the Court would then list as an anticompetitive effect of vertical maximum price fixing that it might acquire the attributes of resale price maintenance. More mysteriously, Justice Harlan endorsed the logic of *Dr. Miles* without citing the case.

Instead of pointing to *Dr. Miles*, the Court cited four other cases for the proposition that "*resale* price fixing is a per se violation of the law."[24] Two of them, *United States v. Trenton Potteries Co.*[25] and *United States v. Socony-Vacuum Oil Co.*,[26] involved conventional horizontal price fixing, the essence of which is an agreement among competitors to raise the price they charge for a product. Consumers are injured because the price is above and the quantity below the levels that would prevail under competition among suppliers. Neither involved resale price fixing. Another, *United States v. McKesson & Robbins, Inc.*,[27] con-

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21 *Id.* at 407.

22 *See Albrecht*, 390 U.S. at 157–58 (Harlan, J., dissenting).

23 *See id.* at 151 n.7. The special services theory is usually attributed to Lester Telser, though the Court did not cite his article. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960). For example, Richard Posner has remarked that the special "service argument . . . originated in Telser." Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 11 n.26 (1981). But the essence of the theory was expounded earlier by Ward Bowman in an article the Court did cite: Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 840–43 (1955), *cited in Albrecht*, 390 U.S. at 151 n.7. Indeed, Benjamin Klein and Kevin Murphy point to similar reasoning in much earlier articles: T. H. Silcock, *Some Problems of Price Maintenance*, 48 ECON. J. 42 (1938); F. W. Taussig, *Price Maintenance*, 6 AM. ECON. REV., March 1916, at 170. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 265 n.1 (1988).

24 *Albrecht*, 390 U.S. at 151 (emphasis added).

25 273 U.S. 392 (1927) (holding that an agreement among firms with market power in the supply of vitreous pottery fixtures to fix prices of sanitary pottery is illegal).

26 310 U.S. 150 (1940) (holding that an agreement among competing oil companies to raise the price of gasoline was illegal per se).

27 351 U.S. 305 (1956) (holding that an agreement between a wholesaler—who also manufactured and sold drugs to other wholesalers—and independent wholesalers to fix the minimum price at which the independent wholesalers could resell the product violated Section 1 and was not protected by the fair trade laws).

cerned the validity under the Miller-Tydings Act[28] and the McGuire Act[29] of what amounted to minimum resale price fixing.[30] This practice can serve a number of efficiency-enhancing functions,[31] one of which the Court described in *Albrecht.* Alternatively, when used on an industry-wide basis, it can facilitate horizontal price fixing at either the supplier or dealer level.[32] In any event, neither horizontal collusion to fix the price of products sold nor resale price maintenance has the same economic effects as maximum vertical price fixing.

Only the fourth case, *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*,[33] involved maximum resale price fixing; indeed, Justice Harlan noted that *Kiefer-Stewart* was "the only case in this Court in which maximum resale prices have actually been held unlawful."[34] The Court in fact relied principally on *Kiefer-Stewart,* declaring that the case "was correctly decided and we adhere to it."[35] That case involved an agreement between what the Court viewed as competing liquor distillers to impose maximum resale prices on their wholesalers.[36] Justice Harlan insisted that the horizontal aspect of the arrangement was critical to the Court's decision.[37] The Court there did say that "an agreement *among competitors* to fix maximum resale prices" violates the Sherman Act.[38] It also observed that either of the distillers "*acting individually* perhaps might have refused to deal" with wholesalers, suggesting that

28 Miller-Tydings Fair Trade Act, ch. 690, 50 Stat. 693 (1937) (codified as amended at 15 U.S.C. § 1 (1995)).

29 McGuire Act of 1952, ch. 745, 66 Stat. 632 (codified at 15 U.S.C. § 45 (1995)).

30 These two laws shielded from federal antitrust attack resale price maintenance arrangements that were adopted pursuant to state fair trade laws. Congress repealed this protection in 1975. *See* Consumer Goods Pricing Act, Pub. L. No. 94-145, 89 Stat. 801 (1975) (codified at 15 U.S.C. § 45 (1995) (amending 15 U.S.C. §§ 1, 45)).

31 For recent surveys, see Roger D. Blair & James M. Fesmire, *Communications: The Resale Price Maintenance Policy Dilemma,* 60 S. ECON. J. 1043 (1994); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation,* 34 J.L. & ECON. 263 (1991); Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom,* 63 ANTITRUST L.J. 59 (1994). A recent contribution is David A. Butz, *Vertical Price Controls with Uncertain Demand,* 40 J.L. & ECON. 433 (1997).

32 *See generally* Telser, *supra* note 23, at 104; Ippolito, *supra* note 31, at 281–82.

33 340 U.S. 211 (1951).

34 *Albrecht v. Herald Co.*, 390 U.S. 145, 164 (1968) (Harlan, J., dissenting).

35 *Id.* at 152.

36 The manufacturers were affiliated, and they would not have been treated as separate entities capable of conspiring after *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) (holding that a parent corporation and its wholly-owned subsidiary constitute a single economic actor for purposes of Section 1). But at the time of *Kiefer-Stewart,* the agreement between the affiliated companies selling competing products was treated as a horizontal combination.

37 *See Albrecht,* 390 U.S. at 164 (Harlan, J., dissenting).

38 *Kiefer-Stewart,* 340 U.S. at 213 (emphasis added).

unilateral imposition of a resale price cap might similarly have been permitted.[39] Though Justice Harlan did not use the term "monopsony," he reasoned in effect that an agreement among manufacturers may represent the creation of monopsony power in the "purchase" of distribution services from dealers. The "price" that manufacturers pay for distribution is the difference between their wholesale prices and the resale prices; by capping resale prices and setting wholesale prices, manufacturers squeeze the dealers' profit margin and depress the price they pay for distribution below a competitive level.[40] Collusion among buyers is thus the mirror image of collusion among sellers, and like the latter is illegal per se.[41] He did not pursue the analysis further, but Justice Harlan might have argued that, by contrast, if a single buyer of distribution services has monopsony power, a vertical maximum price restraint, though perhaps an agreement, represents only the exploitation of that power, not its creation. The mere refusal to pay more than a monopsony price cannot be deemed unlawful anymore than can the mere refusal to charge less than a monopoly price. At the very least, the Supreme Court has never held that the pure exploitation of market power by a monopsonist, whatever the product, violates the antitrust laws.

If this is what the *Kiefer-Stewart* Court meant, it might have cited *Swift & Co. v. United States*,[42] where the Court condemned a conspiracy among buyers not to bid against each other at livestock auctions,[43] an arrangement that "compell[ed] the owners of such stock to sell at *less* [sic] prices than they would receive if the bidding really was competitive."[44] Or it might have cited *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*,[45] where the Court condemned an agreement among sugar refineries that had the effect of lowering the price they paid farmers for sugar beets. It cited neither. Instead, it cited only *Socony-Vacuum*.[46] That case did involve a combination among competitors, giving some credence to the argument that the *Kiefer-Stewart*

39 *Id.* at 214 (emphasis added).

40 *See Albrecht*, 390 U.S. at 164–65; *see also* Khan v. State Oil Co., 93 F.3d 1358, 1361 (7th Cir. 1996), *rev'd*, 118 S. Ct. 275 (1997). We analyze this concern below and reject it as a likely explanation for maximum price restraints. *See infra* notes 172–86 and accompanying text.

41 This proposition had been established at the time of *Albrecht* (*see, e.g.*, Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219 (1948)), but Justice Harlan cited no authority.

42 196 U.S. 375 (1905).

43 *See id.* at 400.

44 *Id.* at 391 (emphasis added).

45 334 U.S. 219 (1948).

46 *See Kiefer-Stewart*, 340 U.S. at 213.

Court meant only to condemn horizontal agreements to impose maximum resale price restraints. And the *Socony-Vacuum* Court did make the now-famous declaration: "Under the Sherman Act a combination formed for the purpose and with the effect of raising, *depressing*, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se."[47] But the reference to depressing prices in this passage is dicta, for the combination in that case had the effect of raising prices.[48] Still, failure to cite the most appropriate precedents does not mean that the *Kiefer-Stewart* Court was primarily concerned about something other than the creation of monopsony power. The Court might have considered the pithy, relatively recent dicta perfectly adequate. Besides, the *Socony-Vacuum* Court did cite *Swift*.[49]

The majority dismissed Justice Harlan's reading of *Kiefer-Stewart*, commenting that it was "scarcely derivable from the opinion in that case."[50] Yet that opinion, running a mere five pages, does not contain much analysis of any kind. If Justice Harlan's reading was "scarcely derivable," so was the majority's contrary reading. Perhaps the best argument the *Albrecht* Court could have made is that *Kiefer-Stewart* did not depend on the horizontal agreement, but on the defendants' contention that their agreement was legally justified because it constrained the prices of wholesalers, who had conspired to raise prices.[51] The Court acknowledged that the distillers had introduced evidence of a wholesalers' cartel, but it rejected the defense.[52] One might argue that, just as high retail prices brought about by a downstream price fixing conspiracy do not justify a maximum resale constraint imposed from above, high retail prices resulting from exclusive distributorships do not justify a vertical maximum price constraint, whether one upstream firm imposes it or several competing upstream firms agree to impose it.

In the end, the basis of *Kiefer-Stewart* is infirm, and so the support it lent *Albrecht* was shaky. If *Kiefer-Stewart* was intended to outlaw combinations among competitors to acquire and exploit monopsony

47 *Socony-Vacuum*, 310 U.S. at 223 (emphasis added).

48 The Court noted that the arrangement condemned in *Socony-Vacuum* had the effect of creating a "floor," which kept prices higher than they might have been. *Id.* at 223.

49 *See id.* at 222.

50 *Albrecht*, 390 U.S. at 152 n.8.

51 *See Kiefer-Stewart*, 340 U.S. at 214.

52 The Court concluded: "The alleged illegal conduct of petitioner . . . could not legalize the unlawful combination by respondents nor immunize them against liability to those they injured." *Id.*

power, that intent was not explicit. Under such a reading of the case, the arrangement in *Albrecht* was not illicit, both because it did not involve a horizontal agreement and because the newspaper publisher had no apparent monopsony power in the purchase of distribution services.[53] But the problem with this interpretation of *Kiefer-Stewart* is that the liquor distillers that entered into the agreement to impose a resale price cap in that case had no monopsony power. They were not attempting to depress the price of distribution below the competitive level, but to prevent distributors from raising the price of liquor to a supracompetitive level. Holding the defendants liable in *Kiefer-Stewart* then makes sense only if the benefits of a per se rule prohibiting all horizontal agreements to fix maximum resale prices outweigh its costs. To reach that conclusion, one would have to believe that these agreements typically represent the acquisition and exploitation of monopsony power rather than a device to increase efficiency, such as by restraining a downstream cartel.

Had the *Albrecht* Court looked below for guidance, it would not have found much. In *Quinn v. Mobil Oil Co.*,[54] the First Circuit had held that, where a gasoline supplier terminated a dealer because he would not reduce his retail price to that suggested by the manufacturer, the dealer could not recover against his supplier under Section 1 for want of an agreement. In a concurring opinion, which Justice Harlan cited, Judge Coffin went further, concluding that even an agreement between a single manufacturer and its dealers as to maximum resale prices passes antitrust muster.[55] Judge Coffin reasoned much like Justice Harlan after him, though in distinguishing *Kiefer-Stewart* he did not suggest that the key was the creation of monopsony power.[56] Judge Aldrich in dissent would have found the defendant liable under *Kiefer-Stewart* and *Simpson v. Union Oil Co.*[57] In *Broussard v. Socony Mobil Oil Co.*,[58] the Fifth Circuit had held that a gasoline supplier was not entitled to summary judgment in a suit brought by one

53 *See infra* notes 172–76 and accompanying text.

54 375 F.2d 273 (1st Cir. 1967), *cert. dismissed*, 389 U.S. 801 (1967).

55 *See id.* at 276 (Coffin, J., concurring).

56 *See id.* at 277–78 (Coffin, J., concurring). Judge Coffin explained that an agreement between manufacturers to impose maximum resale prices is unlawful because "(a) an identical or parallel system of maximum prices between two competing sets of dealers is likely to become a system of minimum prices and (b) the motive of each manufacturer is likely to be something other than maximizing his own return." *Id.* Neither argument makes much sense.

57 377 U.S. 13 (1964) (holding that vertical, minimum retail price fixing imposed by a manufacturer under the guise of consignment agreements is illegal per se).

58 350 F.2d 346 (5th Cir. 1965).

of its dealers where the dealer unwillingly reduced his price at the insistence of the defendant.

In all, *Albrecht* was a foundational case. Only in *Kiefer-Stewart* had the Supreme Court confronted an apparently similar issue, but the cases were potentially distinguishable on important legal and economic dimensions. And the opinion in that case was hardly edifying.

B. Between Albrecht *and* ARCO

During the first nine years after *Albrecht,* the lower courts applied the rule laid down there in a handful of cases.[59] But by 1977, the Supreme Court's approach to antitrust had changed fundamentally. The Court came to see efficiency, which often can be described as consumer welfare, as the goal of antitrust law, and it set about to rework antitrust doctrine accordingly.[60] Two decisions issued in 1977 bore heavily on the continuing vitality of the *Albrecht* rule.

In *Continental T.V., Inc. v. GTE Sylvania, Inc.,*[61] the Court held that nonprice vertical restraints imposed by a manufacturer on its dealers are lawful if reasonable. Thus, for example, a manufacturer can agree to grant a distributor an exclusive territory. Recall that the *Albrecht* Court had all but held that exclusive dealerships are illegal per se. Some lower courts, therefore, interpreted *Sylvania* as a repudiation of the logic of *Albrecht,* and hence its result: if a manufacturer can confer exclusive territories on its dealers in order to stimulate the provision of point-of-sale services by eliminating the risk of free riding,

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59 *See, e.g.,* Knutson v. Daily Review, Inc., 548 F.2d 795 (9th Cir. 1976) (holding that a newspaper publisher was liable in an action brought by one of its dealers alleging vertical maximum price fixing); Bowen v. New York News, Inc., 522 F.2d 1242 (2nd Cir. 1975) (holding that an otherwise illegal maximum resale price agreement between a newspaper and its dealers was protected under the fair trade laws); Blankenship v. Hearst Corp., 519 F.2d 418 (9th Cir. 1975) (holding that a newspaper distributor could sue the publisher for fixing the maximum prices that could be charged by carriers who purchased papers from the distributor); Greene v. General Foods Corp., 517 F.2d 635 (5th Cir. 1975) (holding that a food supplier's actions to prevent its distributor from selling its products to national buyers at prices above those set by the supplier constituted illegal vertical maximum price fixing); Milsen Co. v. Southland Corp., 454 F.2d 363 (7th Cir. 1971) (holding that the holder of several convenience store franchises was entitled to a preliminary injunction preventing termination of its franchises where the franchisor, inter alia, required franchisees to adhere to the maximum retail prices set by the franchisor on products some of which the franchisor supplied).

60 *See generally* ROBERT H. BORK, THE ANTITRUST PARADOX ix–xiv, 426–39 (Maxwell Macmillan Int'l 1993) (1978); John E. Lopatka, *Stephen Breyer and Modern Antitrust: A Snug Fit,* 40 ANTITRUST BULL. 1, 23–45 (1995).

61 433 U.S. 36 (1977).

thereby granting each a monopoly in its brand, then surely the manufacturer can constrain the prices that the monopolist dealer can charge.[62] Besides, if *Albrecht* was based on the premise that the protection of dealers is a worthy, independent antitrust objective,[63] then the implication of *Sylvania* that only consumer welfare matters undercuts the older case. That reasoning, of course, would have been more compelling if the *Sylvania* Court had not explicitly reaffirmed the per se rule against vertical minimum price fixing,[64] a practice that typically serves the interests of consumers. Still, the argument was strong enough to persuade these courts.

In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,[65] the Court articulated the antitrust injury doctrine. The Court held that, in order to recover damages pursuant to Section 4 of the Clayton Act,[66] a private plaintiff must suffer "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful."[67] The doctrine is based on the premise that Congress intended to allow private parties to sue under the antitrust laws only to remedy the kind of harm it wanted to avoid.[68] Because Congress intended the antitrust laws to deter practices that reduce efficiency, and hence consumer welfare, a private plaintiff seeking antitrust relief must assert an injury that predictably varies in size with the ineffi-

62 *See, e.g.*, Acquaire v. Canada Dry Bottling Co., 24 F.3d 401 (2nd Cir. 1994) (questioning validity of *Albrecht* in light of *Sylvania*); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 706–07 (7th Cir. 1984) (Posner, J.) (suggesting that "the continued vitality of *Albrecht* is in doubt after" *Sylvania*). Indeed, the Supreme Court later acknowledged that, after *Sylvania*, "[t]he procompetitive potential of a vertical maximum price restraint is more evident . . . than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful per se in 1968." Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 343 n.13 (1990).

63 *See supra* note 11.

64 *See Sylvania*, 433 U.S. at 51 n.18.

65 429 U.S. 477 (1977).

66 15 U.S.C. § 15 (1994) (allowing "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" to recover treble damages).

67 *Brunswick*, 429 U.S. at 489. Later, in *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986), the Court held that a plaintiff must allege threatened antitrust injury in order to obtain an injunction pursuant to Section 16 of the Clayton Act, 15 U.S.C. § 26 (Supp. II 1996).

68 As Judge Posner has noted, this principle is an application of the long-accepted tort doctrine that a plaintiff cannot establish that the defendant was negligent per se merely by showing that the defendant violated a statute and that the plaintiff was injured as a result. Rather, the plaintiff must show that the statute was intended to prevent the kind of harm the plaintiff suffered. *See* Jack Walters & Sons Corp. v. Morton Building, Inc., 737 F.2d 698, 708–09 (7th Cir. 1984).

ciency produced by the defendant's conduct.[69] When a supplier and its dealers agree to a resale price ceiling, both those dealers and competing dealers may lose profits. Some courts held that the profits lost by competing dealers because of a maximum resale price restraint do not constitute antitrust injury, for they represent losses incurred as a result of stiffer competition from rivals charging lower prices, not as a result of lessened competition.[70] Other courts held that even the dealers subject to the vertical price cap suffer no antitrust injury, for the profits they are prevented from earning are monopoly profits ineligible for antitrust protection.[71] Not every court interpreted *Sylvania* and *Brunswick* as effectively overruling *Albrecht*.[72] But the foundation had cracked.

Then came *ARCO*.[73] The defendant, an integrated oil company, imposed retail price ceilings on its independent, branded dealers. An operator of competing gasoline stations lost profits as a result and challenged the maximum retail price agreements between ARCO and its ARCO-brand dealers under Section 1, claiming its lost profits as damages. The Supreme Court expressly reaffirmed the antitrust injury doctrine, declaring that a private party cannot recover unless it is "adversely affected by an anticompetitive aspect of the defendant's conduct."[74] The Court then held that profits lost by a firm as a result of an agreement between its competitor and that competitor's supplier setting a maximum, nonpredatory resale price do not constitute antitrust injury. The Court assumed arguendo that vertical, maximum price fixing continues to be illegal per se.[75] But it concluded that the loss suffered by a rival of a firm pricing under a ceiling does not resemble any of the harms described in *Albrecht*.[76] Indeed, if any of

69 *See generally* William H. Page & John E. Lopatka, *Antitrust Injury, Merger Policy, and the Competitor Plaintiff*, 82 IOWA L. REV. 127 (1996); William H. Page, *The Scope of Liability for Antitrust Violations*, 37 STAN. L. REV. 1445 (1985).

70 *See, e.g.*, Indiana Grocery, Inc. v. Super Valu Stores, Inc., 864 F.2d 1409 (7th Cir. 1989); *see also* Roger D. Blair & Jeffrey L. Harrison, *Rethinking Antitrust Injury*, 42 VAND. L. REV. 1539 (1989).

71 *See, e.g., Jack Walters*, 737 F.2d at 708–09; Kestenbaum v. Falstaff Brewing Corp., 575 F.2d 564 (5th Cir. 1978).

72 *See, e.g.*, Northwest Publications, Inc. v. Crumb, 752 F.2d 473 (9th Cir. 1985); Blanton v. Mobil Oil Corp., 721 F.2d 1207 (9th Cir. 1983); Auburn News Co. v. Providence Journal Co., 659 F.2d 273 (1st Cir. 1981); Yentsch v. Texaco, Inc., 630 F.2d 46 (2nd Cir. 1980); Arnott v. American Oil Co., 609 F.2d 873 (8th Cir. 1979).

73 Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990) [hereinafter ARCO].

74 *Id.* at 339.

75 *See id.* at 335 n.5.

76 *See id.* at 336.

those harms does materialize, the rival would enjoy a competitive boon. Thus, for example, if the price were set too low to allow dealers to provide desired services or set in such a way as to channel sales through large distributors, competing dealers would benefit.[77] Similarly, a competitor would benefit if rival dealers entered into an arrangement that took on the characteristics of a minimum price fixing conspiracy.[78]

Although the Court held that dealers cannot challenge vertical, nonpredatory, maximum price fixing to which their competitors are parties, some passages of the opinion suggest that even dealers subject to supplier-imposed price ceilings suffer no antitrust injury. For instance, the Court broadly proclaimed, "[I]n the context of pricing practices, only predatory pricing has the requisite anticompetitive effect."[79] Then, without distinguishing between those dealers constrained by the arrangement and those competing with them, the Court declared, "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. Hence, they cannot give rise to antitrust injury."[80] If capped prices "cannot give rise to antitrust injury," no private party, including a dealer subject to the ceiling, can sue. Further, the Court implied that the demise of an inefficient competing dealer as a result of vertical maximum price fixing does not constitute an antitrust injury.[81] If maximum resale price fixing channels sales through large dealers and thereby drives from the market inefficient small dealers subject to the constraint, one would similarly assume that the loss of those dealers does not constitute antitrust injury.

Yet even if one could derive an argument from the logic of the opinion that dealers constrained by price ceilings imposed by their suppliers cannot obtain antitrust relief, the Court quashed it in unambiguous dicta. The Court remarked that, if vertical, maximum price fixing "causes the anticompetitive consequences detailed in *Albrecht*, consumers and the manufacturers' own dealers may bring suit."[82] *ARCO*, therefore, squarely rejected, albeit in dicta, the developing line of authority in the lower courts that dealers bound by resale price caps suffer no antitrust injury. But it did more. It implicitly rejected the proposition that *Albrecht* did not survive *Sylvania*. The *ARCO* Court

77 *See id.* at 336–37.
78 *See id.* at 337.
79 *Id.* at 339.
80 *Id.* at 340.
81 *See id.* at 337–38 n.7.
82 *Id.* at 345.

acknowledged the procompetitive potential of vertical maximum price fixing and noted that, because of *Sylvania,* the consumer benefits of the practice are more significant than they were when *Albrecht* was decided.[83] Nevertheless, the Court stated that the practice can be challenged by consumers and constrained dealers.

In all, *ARCO* has a schizophrenic quality.[84] The Court was unwilling to reconsider the rule that maximum vertical price fixing is illegal per se, but it offered compelling explanations of the efficiency-enhancing capacity of the practice and little discussion of its anticompetitive potential. It explained why rival dealers suffer no antitrust injury using logic suggesting that constrained dealers likewise suffer no such injury, but declared that constrained dealers can sue.

C. *The Impact of* ARCO *on the Lower Courts*

ARCO's wake buffeted the lower courts. Only an audacious court would have denied antitrust standing to a dealer complaining about a maximum resale price agreement imposed upon him by his supplier.[85] But why the injury he suffers from being forced to lower his prices is antitrust injury was obscure. The "*anticompetitive* consequences detailed in *Albrecht*" were far from obviously anticompetitive.[86]

Thus, the *Albrecht* Court's first assertion, that maximum resale price fixing "may severely intrude upon the ability of buyers to compete,"[87] is opaque. If dealers are injured because of the other consequences specified, then the suggestion has no independent content. If they are otherwise injured, the source of that injury is simply impossible to see. To be sure, a maximum resale price constraint will limit

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83 *See id.* at 343 n.13.

84 For a detailed analysis of *ARCO,* see Roger D. Blair & Gordon L. Lang, Albrecht *After* ARCO*: Maximum Resale Price Fixing Moves Toward the Rule of Reason,* 44 VAND. L. REV. 1007 (1991).

85 One court was that bold. *See* Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft, 821 F. Supp. 802 (D.P.R. 1993) (granting summary judgment for the defendant on the strength of *ARCO* by concluding that a dealer subject to a maximum resale price restraint suffers no antitrust injury), *vacated,* 19 F.3d 745 (1st Cir. 1994). In *Khan,* the district court also granted summary judgment to a supplier in a case brought by its dealer complaining about resale maximum price fixing, but the court rested its conclusion on the ground that the practice is to be judged under the rule of reason and that the plaintiff had failed to establish the predicates for recovery under that standard. *See* Khan v. State Oil Co., 93 F.3d 1358, 1360 (7th Cir. 1996) (describing the unreported district court decision), *vacated and remanded,* 118 S. Ct. 275 (1997).

86 *ARCO,* 495 U.S. at 345 (emphasis added).

87 *Albrecht,* 390 U.S. at 152.

the dealer's pricing freedom—that is a tautology. But a restraint on liberty, though in some contexts offensive to the Fifth Amendment,[88] does not by itself represent a loss of consumer welfare. Indeed, if suppliers respond to the illegality of resale price caps by integrating into distribution, dealers will not only lose their pricing freedom, but their very existences as dealers.[89]

Second, to claim that the supplier might set prices too low to enable the dealer to provide services that customers want is to deny that the supplier can act in its own best interests. Of course, a supplier typically must determine the services that customers *on average* desire and set a price cap accordingly, for it is often impractical for a supplier to treat multiple retail markets individually. And additional services provided by a particular dealer in an unusual market might benefit the supplier, the dealer, and his customers.[90] But the supplier will only willingly injure itself in the idiosyncratic market—by setting the ceiling too low—if consumers and the supplier benefit in the aggregate.[91] The economic interests of the supplier and consumers coalesce. Preventing the price cap in an effort to favor the small group of consumers hardly serves the interests of consumers collectively.

Third, if *Albrecht* meant to protect small, inefficient dealers by preventing a practice that favors large, efficient ones, the harm sought to be averted is not antitrust injury. Antitrust injury presupposes a consumer welfare loss, and just how consumer welfare is threatened by channeling distribution through large dealers is unclear.[92] Perhaps a small dealer would provide more service than large dealers to consumers who desire it, albeit at a higher price. The elimination of

88 U.S. CONST. amend. V ("No person shall be . . . deprived of life, liberty, or property, without due process of law . . . .").

89 *See* 8 PHILLIP AREEDA, ANTITRUST LAW ¶ 1635, at 395 (1989).

90 It is not likely, however, that *Khan* was a case in which transaction costs prohibited the supplier from setting an individual profit-maximizing price in a market in which an unusually high level of services was desired. *See infra* note 195.

91 Ward Bowman explained the essence of this phenomenon in the context of minimum resale price fixing. *See* Bowman, *supra* note 23, at 842–43. He suggested that, if a manufacturer's product is sold in one market in which the product alone is desired and in another market in which the product plus service is desired, and if the manufacturer cannot sell his product at different prices to dealers in these markets, "the manufacturer is faced with a difficult question of sales policy." *Id.* at 842. The manufacturer must choose between supporting the service dealers or the non-service dealers, and it will make its choice in the way that maximizes its profits. Either way, of course, some consumers gain and others lose.

92 Consumers choose to buy from the large, low-price dealers and thereby cause the demise of the small, inefficient dealers. In effect, consumers vote for efficiency over protection.

the small dealer would indeed injure those consumers who would thereby be foreclosed from services they value. But this argument becomes a close variant of the first one, that the cap may be set too low to provide the services consumers demand, and it fails for the same reason: the manufacturer will act to deny consumers services they value only if it is efficient in the aggregate to do so.

Finally, vertical minimum price fixing is itself often procompetitive, and when it is not, it can be condemned for what it is—anticompetitive resale price maintenance. It need not be outlawed for what it pretends to be. Besides, when a dealer complains, an easy test exists to determine whether maximum vertical price fixing in form is minimum vertical price fixing in fact, and all of the Court's maximum resale price cases fail it. One cannot look for price uniformity. If the price ceiling serves any economic function, it will constrain prices because, to one extent or another, all dealers want to price above the cap. Actual prices, therefore, will indeed tend to be uniform. Rather, the tip-off has to do with cheating on the agreement. Any cheating on a minimum price agreement would take the form of a price *below* the stipulated resale price. But in *Albrecht* and *ARCO,* as well as in *Kiefer-Stewart,* for that matter, the dealer complained that it was prevented from raising the price. If maximum vertical price fixing is going to be condemned because it has the effects of resale price maintenance, that ground crumbles when the supplier stops the dealer from increasing the price.

In the end, lower courts were compelled to reach a legal conclusion without much of an economic rationale, and predictably they struggled. What is worse, if courts were forced to hold that constrained dealers suffer antitrust injury when they could perceive no anticompetitive effect flowing from the practice, maybe antitrust injury could be discerned in a score of practices that apparently have no adverse economic consequences. Despite the *ARCO* Court's ardent refusal "to dilute the antitrust injury requirement," the vitality of that doctrine was indeed placed in jeopardy.[93] Two appellate court decisions, each authored by a respected antitrust scholar, illustrate the dilemma.

1. The First Circuit: *Caribe BMW*

In *Caribe BMW, Inc. v. Bayerische Motoren Werke AG,*[94] the First Circuit, in an opinion by then-Chief Judge Breyer, held that a car dealer might be able to recover profits lost as a result of a maximum resale

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93 *ARCO,* 495 U.S. at 345.

94 19 F.3d 745 (1st Cir. 1994).

price restraint imposed on it by its supplier, and so it vacated the grant of summary judgment for the defendant.[95] But Judge Breyer was torn. He acknowledged, in an understatement, that "*Albrecht* has proved a controversial case," noting that it outlawed procompetitive uses of maximum resale price fixing.[96] But he tried to make sense of *ARCO* by explaining how the challenged practice can have anticompetitive consequences and thereby inflict antitrust injury on a dealer, such as the plaintiff Caribe, bound by the price restraint. In general, he noted that the practice does not cause antitrust harm unless it reduces the number of those dealers subject to it or reduces their sales.[97] Specifically, he stated, "At least in theory, if customers would have preferred a higher price and consequently better product quality or greater service, the agreement forced Caribe to provide less of what they wanted; the agreement thereby might have led to lower Caribe profits."[98] He did not explain that the supplier would have injured itself by imposing such a price ceiling unless the dealer's particular market was unusual and, given relevant transaction costs, could not profitably be treated differently. Judge Breyer continued, "And, *at least in theory*, if the agreement helped other, larger BMW dealers, Caribe is the firm that would have suffered."[99] True enough, but Judge Breyer did not explain why Caribe's suffering in that case would have related to an inefficient (i.e., anticompetitive) aspect of the arrangement. Judge Breyer did not even allude to the possibility that BMW's pricing system took on all of the effects of minimum resale price fixing, perhaps because he realized that Caribe was not trying to lower its prices. Nor did he cite the abject limitation of the dealer's pricing freedom, perhaps because he understood that the concept is vacuous.

Use of the qualification "at least in theory," twice no less, seems to bespeak skepticism. The impression that Judge Breyer harbored doubts that the practice would in fact have the effects described is reinforced by his further admonition that, if the profits the plaintiff lost because of the price cap were supracompetitive profits, "it is at least arguable that no 'antitrust injury' occurred."[100] In all, the opin-

95 For a critique of the decision, see Roger D. Blair, *The Ghost of* Albrecht*:* Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft, 40 ANTITRUST BULL. 205 (1995). Hereafter, we omit for convenience the "chief" in reference to then-Chief Judge Breyer.

96 *Caribe BMW*, 19 F.3d at 753.

97 *See id.* at 753.

98 *Id.* (emphasis added).

99 *Id.* (emphasis added).

100 *Id.* at 753–54.

ion reads as that of a judge uneasy with the conclusion he feels compelled to reach.

2. The Seventh Circuit: *Khan*

In *Khan* itself,[101] Chief Judge Posner[102] exhibited the same intellectual conflict, only it was more acute, and his disquietude more painful to witness. The gasoline dealer in *Khan* sought to recover profits lost as a result of what was in effect a resale price cap imposed by his supplier. State Oil, the supplier, owned a convenience store and gas station that it leased to Khan for the sale of "Union 76" gasoline.[103] Under the lease contract, Khan was required to buy all of his gasoline from State Oil.[104] State Oil would suggest a retail price and sell gasoline to Khan for 3.25 cents less than that price.[105] If Khan believed that the retail price was too low, he could ask State Oil to raise it. If State Oil refused, Khan could raise his price anyway, but then Khan would be required to rebate the difference between his new price and the suggested price multiplied by the quantity sold. As a result, the contract required Khan to rebate the entire incremental profit earned by raising retail price above the one State Oil stipulated. After Khan fell behind in his lease payments, State Oil moved to evict him.[106] While those proceedings continued, the state court appointed a receiver to operate the station, and for five months the receiver increased profits, apparently by raising the price of premium grades above the suggested maxima and failing to rebate the extra profit.[107] Khan inferred that he would have earned higher profits

101 Khan v. State Oil Co., 93 F.3d 1358 (7th Cir. 1996), *vacated and remanded*, 118 S. Ct. 275 (1997).

102 Hereafter, we omit for convenience the "Chief" in reference to Chief Judge Posner.

103 *See Khan*, 93 F.3d at 1359-60. The circuit court did not mention that Khan leased a convenience store from State Oil, but the Supreme Court did. *See* Khan v. State Oil Co., 118 S. Ct. 275, 278 (1997). Khan himself signed the dealership contract with State Oil, and his corporation, Khan & Associates, Inc., operated the station. *See Khan*, 93 F.3d at 1360. Both Khan and his corporation sued State Oil, but for convenience we refer to them collectively as "Khan."

104 *See Khan*, 93 F.3d at 1360.

105 *See id.*

106 *See id.* at 1365.

107 *See id.* The circuit court reported only that the receiver charged a higher price for gasoline than the specified maximum. The Supreme Court, however, noted that the receiver raised price above the maximum only for premium grades and lowered the price of regular-grade gasoline. *See Khan*, 118 S. Ct. at 278. According to the Court, the receiver increased his profit margin in part by reducing the price of regular-grade gasoline below suggested price. *See id.* Under the contract, however, if

while he was operating the station had he not been constrained by the resale price ceiling. The court had no trouble characterizing the arrangement as maximum vertical price fixing, for the contract made it worthless for the dealer to price above the suggested ceiling.[108] The rebate mechanism was simply a method of enforcing the maximum resale price agreement, and one probably equally effective as terminating a dealer that priced above the cap.

Judge Posner traced the evolution of the rules against price fixing, calling the Court's decision to make vertical minimum price fixing illegal per se "questionable."[109] He outlined the monopsony potential of a horizontal agreement to impose maximum resale price restraints, suggesting implicitly that it justified per se condemnation.[110] He also articulated an efficiency-increasing explanation for vertical maximum price fixing.[111] Thus, if a distinctive brand gives the supplier at least a modicum of monopoly power and, in order to induce dealers to provide services, the supplier selects dealer locations to limit competition among its dealers, the supplier might fix a maximum resale price to prevent the dealers from exploiting their monopoly positions to the supplier's detriment.[112] But he observed, with a hint of exasperation, "Despite these points, the Supreme Court has

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Khan lowered retail price below the suggested price, State Oil was not obligated to reduce wholesale price; Khan originally argued that this feature of the contract amounted to minimum resale price fixing, but Judge Posner rejected the claim, *Khan*, 93 F.3d at 1360, and it was not considered by the Supreme Court. After remand of the case by the Supreme Court for consideration of the maximum price fixing claim under the rule of reason, the plaintiff dropped this claim. *See* Khan v. State Oil Co., 143 F.3d 362 (7th Cir. 1998). Instead, he reasserted his contention that the arrangement with State Oil amounted to minimum vertical price fixing. He claimed that, as a practical matter, he could not sell below the price suggested by State Oil because he could not afford a smaller margin between wholesale and retail price. *See id.* at 364. Again, Judge Posner rejected the argument, this time calling it "frivolous": "[I]t amounts to saying that a supplier must reduce his price to his retailer in order to enable the retailer to cut prices without sacrifice of margin. A supplier is free to charge any price he wants to his retailers." *Id.*

108 *See Khan*, 93 F.3d at 1360–61. Khan also asserted a cause of action for breach of contract, claiming that, by being prevented from earning higher profits by pricing below the suggested retail price, he was denied his implicit contractual right to earn a realistic competitive return on his investment. *See id.* at 1366. State Oil conceded its contractual obligation to permit Khan to earn such a return, but the evidence was insufficient to permit the inference that Khan was denied the opportunity to earn a normal return. *See id.*

109 *Id.* at 1361.

110 *See id.*

111 *See id.* at 1362.

112 For a detailed economic analysis of the successive monopoly phenomenon, see *infra* notes 160–68 and accompanying text.

thus far refused to reexamine the cases in which it has held that resale price fixing is illegal per se regardless of the competitive position of the price fixer or whether the price fixed is a floor or a ceiling."[113]

The defendant argued that *Albrecht* was inconsistent with the Court's antitrust injury cases and was thus no longer good law. The court was impressed. Wrote Judge Posner, "We have considerable sympathy with the argument . . . . In fact, we think the argument is right and that it may well portend the doom of *Albrecht*."[114] Nevertheless, the court concluded that the Supreme Court had not expressly overruled *Albrecht* and that, as an inferior court, it had no choice but to apply the precedent:

> Yet despite all its infirmities, its increasingly wobbly, moth-eaten foundations, *Albrecht* has not been expressly overruled . . . . And the Supreme Court has told the lower federal courts, in increasingly emphatic, even strident, terms, not to anticipate an overruling of a decision by the Court; we are to leave the overruling to the Court itself. *Albrecht* was unsound when decided, and is inconsistent with later decisions by the Supreme Court. It should be overruled. Someday, we expect, it will be. . . . [But] [i]t is not our place to overrule *Albrecht*; and *Albrecht* cannot fairly be distinguished from this case.[115]

Indeed, in determining that the Court had never expressly overruled *Albrecht*, Judge Posner understated the vitality of the case. He noted that the Court in *ARCO* "was willing to assume only '*arguendo*' that *Albrecht* had been correctly decided,"[116] but he did not mention that the Court also affirmatively stated that dealers subject to the constraint and consumers are entitled to sue.

Although both Judge Breyer and Judge Posner reluctantly found that a dealer bound by a price cap may challenge it, they reconciled the result with the antitrust injury doctrine in significantly different ways. Judge Breyer reasoned that vertical maximum price fixing can have anticompetitive effects in an economically meaningful sense, and that a dealer subject to the ceiling can suffer an injury related to the anticompetitive aspect of the restraint. Thus, he even went so far as to suggest that not every constrained dealer suffers antitrust injury. A

113 *Khan*, 93 F.3d at 1362.

114 *Id.* at 1363. Judge Posner went on to cite his opinion in *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698 (7th Cir. 1984), noting that the decision suggested that *Albrecht* is inconsistent with *Sylvania*. *See Khan*, 93 F.3d at 1363. Curiously, he did not mention that the court in *Jack Walters* also opined that *Albrecht* is inconsistent with the antitrust injury cases. *See Jack Walters*, 737 F.2d at 708–09.

115 *Khan*, 93 F.3d at 1363–64 (citations omitted).

116 *Id.* at 1363.

dealer that is prevented by his supplier from raising his price above the competitive level might not suffer antitrust injury; a dealer that cannot raise his price to cover the increased costs associated with better service does.[117]

By contrast, Judge Posner was unable to conceive of a case in which vertical maximum price fixing "could cause an injury to the interests protected by antitrust law,"[118] and so he implicitly rejected the claim that the effects first described by the *Albrecht* Court and relied upon by Judge Breyer were in fact anticompetitive. The distinction Judge Breyer drew between a dealer losing monopoly profits and one unable to provide additional service became meaningless under Judge Posner's logic, for the loss suffered by a dealer never represents an efficiency loss. Moreover, Judge Posner's analysis led him to make the facially surprising assertion that, if no one suffers an antitrust injury, even the federal government would be precluded from challenging vertical maximum price fixing.[119] The antitrust injury requirement is derived from sections 4 and 16 of the Clayton Act,[120] provisions that authorize private antitrust suits, and would appear to have no bearing on the right of the government to challenge a practice.[121] But Judge Posner likely reasoned that if antitrust injury presupposes inefficiency and no private party ever suffers such harm from maximum resale price fixing, then even the government is barred from attacking the practice because it is not anticompetitive, a condition necessary for a substantive antitrust violation.[122]

Actually, by professing an inability to hypothesize "an injury to the interests protected by antitrust law" flowing from purely vertical, maximum price fixing, Judge Posner either overstated his position or intended to imply that not all inefficient conduct offends the antitrust

117 *See* Caribe BMW, Inc., v. Bayerische Motoren Werke Aktiengesellschaft, 19 F.3d 745, 753–54 (1st Cir. 1994) ("[I]nsofar as Caribe's claim of 'lost profits' refers to 'losses' that occurred because the agreement prevented Caribe from raising prices above the competitive level, it is at least arguable that no 'antitrust injury' occurred.").

118 *Khan*, 93 F.3d at 1364. Judge Posner noted that "State Oil is not able to identify any cases, real or hypothetical, in which the practice condemned in *Albrecht* could cause" an antitrust injury, and he volunteered no such example himself. *Id.*

119 *See id.* at 1364 ("If proof of antitrust injury is required in cases involving the sort of price fixing involved in *Albrecht*, no such case could be brought, whether by a private plaintiff or by the Department of Justice or the Federal Trade Commission.").

120 15 U.S.C. § 15 (1994); 15 U.S.C. § 26 (1996).

121 As the *ARCO* Court explained, the antitrust injury requirement "prevents losses that stem from competition from supporting suits by *private plaintiffs* for either damages or equitable relief." *ARCO*, 495 U.S. 328, 342 (1990) (emphasis added).

122 In other words, if there is no antitrust injury because the practice has no anticompetitive consequences, a substantive rule prohibiting the practice is unjustified.

laws. Recall that he had explained the per se condemnation of horizontal agreements to impose maximum resale price restraints on the ground that they might represent the creation and exploitation of monopsony power in the purchase of distribution services.[123] The arrangement produces an inefficiency, and as Judge Posner implicitly noted, the same effect can result from a wholly vertical maximum price restraint if the upstream firm is a monopsonist.[124] A single supplier with monopsony power in the distribution services market is wildly improbable, but it is not inconceivable.[125] Indeed, Judge Posner imagined it. Either he forgot, or more likely, he would argue that the exploitation of monopsony power that is not created by horizontal collusion, though genuinely inefficient, is not something antitrust law is set against.

Whatever his view of the unilateral exploitation of monopsony power, Judge Posner felt compelled to conclude that the Supreme Court's conception of antitrust injury must include harms that are unrelated to an efficiency loss. He pointed to *Sylvania*, where the Court simultaneously recognized that nonprice vertical restraints can increase competition and asserted that vertical minimum price fixing is illegal per se.

> The Court must think that preventing intrabrand price competition harms an interest protected by the antitrust laws even if the restriction increases competition viewed as a process for maximizing consumer welfare and even if a restriction that had similar effects but was not an explicit regulation of price would be lawful. If this is what the Court believes—and it does appear to be the Court's current position, though not one that is easy to defend in terms of economic theory or antitrust policy—the Court may also think that interfering with the freedom of a dealer to raise prices may cause antitrust injury.[126]

Judge Posner "suspect[ed]" that the Court would not find such a constraint on pricing freedom to be antitrust injury, but had insufficient confidence in his suspicion to declare the *Albrecht* rule defunct.[127] The implication of the Court's decision in *ARCO* to distinguish the complaint of the rival dealer from the complaint of the

123 *See Khan*, 93 F.3d at 1361.

124 *See id.* at 1362 ("As for maximum resale price fixing, *unless* the supplier is a monopsonist he cannot squeeze his dealers' margins below a competitive level . . . .") (emphasis added).

125 For a fuller explanation of this point, see *infra* notes 172–76 and accompanying text.

126 *Khan*, 93 F.3d at 1364.

127 *Id.*

restricted dealer is that "the injury to a dealer like Khan from not being able to raise his price because of a restriction imposed by his supplier is antitrust injury."[128]

In terms of the antitrust injury doctrine, then, the positions taken by Judges Breyer and Posner were both problematic. Judge Breyer ostensibly preserved the integrity of the doctrine by finding that vertical maximum price fixing can have anticompetitive effects, dutifully alluding to the consequences that the Supreme Court in *Albrecht* and *ARCO* had declared to be harmful. But those anticompetitive effects are phantoms. Judge Posner recognized that the practice causes no anticompetitive harm, but was then compelled to mangle the antitrust injury doctrine by proclaiming that it encompasses effects that reflect no efficiency loss, leaving its limits ominously unspecified.

III. *KHAN* IN THE SUPREME COURT

On review of *Khan*, the Supreme Court commended the Seventh Circuit for faithfully applying *Albrecht*,[129] then overruled the case in a unanimous decision written by Justice O'Connor. The Court offered its own sketch of the evolution of antitrust doctrine, beginning with the per se rule against vertical minimum price fixing laid down in *Dr. Miles*.[130] It noted the broad condemnation of horizontal price agreements set forth in *Socony-Vacuum* and the decision in *Kiefer-Stewart* to strike down an agreement between affiliated distillers to impose resale price ceilings.[131] Turning to nonprice distributional restraints, the Court cited *White Motor Co. v. United States*,[132] where the Court refused to hold such restrictions illegal per se for want of sufficient experience analyzing them, and *United States v. Arnold, Schwinn & Co.*,[133] where it decided four years later that it then knew enough to condemn them per se.[134] Interestingly, though understandably, the Court's recitation of this doctrinal history is largely descriptive. Whereas Judge Posner

128 *Id.*

129 The Court remarked, "The Court of Appeals was correct in applying [the] principle [of stare decisis] despite disagreement with *Albrecht*, for it is this Court's prerogative alone to overrule one of its precedents." Khan v. State Oil Co., 118 S. Ct. 275, 284 (1997).

130 *See id.* at 279.

131 *See id.* at 279–80.

132 372 U.S. 253 (1963).

133 388 U.S. 365 (1967).

134 *See Khan*, 118 S. Ct. at 280.

had identified the "questionable next step . . . in the evolution of antitrust law,"[135] the Supreme Court's recounting is distinctly noncritical.

The Court located *Albrecht* in this chronology, observing that the case was decided the term after *Schwinn.*[136] The Court then noted that *Sylvania* overruled *Schwinn* in 1977, thereby providing itself with a modern precedent for overruling an antitrust precedent. It observed that subsequent cases, most importantly including *ARCO*, "hinted that the analytical underpinnings of *Albrecht* were substantially weakened by" *Sylvania.*[137]

Having set the stage, the Court proceeded to explain that its reconsideration of *Albrecht* was guided by essentially two principles. First, the primary purpose of the antitrust laws is to protect interbrand, not intrabrand, competition, a proposition firmly established in *Sylvania* and reaffirmed in *Business Electronics Corp. v. Sharp Electronics Corp.*[138] Second, consumers benefit from low prices, so that condemning practices that reduce prices is especially costly, a proposition recited in *ARCO* and *Matsushita Electrical Industrial Co. v. Zenith Radio Corp.*[139] Given this guidance, the Court found "it difficult to maintain that vertically-imposed maximum prices could harm consumers or competition to the extent necessary to justify their per se invalida-

135 Khan v. State Oil Co., 93 F.3d 1358, 1361 (7th Cir. 1996) (alluding to the per se rule against minimum resale price fixing established in *Dr. Miles*), *vacated and remanded*, 118 S. Ct. 275 (1997).

136 *See Khan*, 118 S. Ct. at 280.

137 *Id.* at 281. The Court cited *Arizona v. Maricopa County Med. Society*, 457 U.S. 332, 348 n.18 (1982), where the Court had opined that vertical restraints are generally more defensible than horizontal restraints and *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341–42 (1987), where the Court had remarked that a unilaterally-imposed vertical restraint "may stimulate interbrand competition even as it reduces intrabrand competition." The *Kahn* Court commented that the *Sylvania* Court "declined to comment on *Albrecht*'s *per se* treatment of vertical *maximum* price restrictions. . . ." *Khan*, 118 S. Ct. at 281 (emphasis added). While this observation is technically correct, the *Sylvania* Court did not explicitly refuse to address vertical *maximum* price fixing, but vertical price fixing generally. Indeed, the passage in *Sylvania* cited by the *Khan* Court seems to relate specifically to minimum resale price maintenance. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 at 51 n.18 (1977).

138 485 U.S. 717, 726 (1988) (holding that an agreement between a manufacturer and a dealer under which the manufacturer stops dealing with a competing dealer because of that dealer's failure to comply with suggested minimum resale prices is not unlawful per se absent a minimum resale price agreement with the surviving dealer). For this proposition, the Court cited *Sharp* but not *Sylvania*. *See Khan*, 118 S. Ct. at 282.

139 475 U.S. 574, 594 (1986) (holding that defendants were entitled to summary judgment in a case alleging a conspiracy to engage in predatory pricing where under the circumstances the claim was economically implausible). *See Khan*, 118 S. Ct. at 282.

tion."[140] The Court recited Judge Posner's explanation as to how maximum resale price fixing can benefit consumers by preventing the exploitation of successive monopolies.[141] The Court also acknowledged that the potential consumer benefits of the practice increase as a result of *Sylvania*, for that opinion raised the probability of dealer monopolies.[142] The Court cautioned, however, that it was not suggesting "that dealers generally possess" market power, nor was it holding that "a ban on vertical maximum price fixing inevitably has anticompetitive consequences in the exclusive dealer context."[143] Turning to the purported benefits of the *Albrecht* rule, the Court listed the adverse consequences of vertical maximum price fixing asserted by the *Albrecht* Court, and referred approvingly to scholarship arguing that the effects are either implausible or not anticompetitive.[144] The Court concluded that these "concerns," which together formed the basis of the *Albrecht* decision, cannot support a rule of per se illegality, though they "can be appropriately recognized and punished under the rule of reason."[145]

The Court bolstered its conclusion that "there is insufficient economic justification for per se invalidation of vertical maximum price fixing" by noting that public enforcers do not challenge the prac-

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140 *Khan*, 118 S. Ct. at 282.

141 *See id.* (citing Khan v. State Oil Co., 93 F.3d 1358, 1362 (7th Cir. 1996). The Court also cited Robert Bork's commentary on *Albrecht* that the newspaper intended to keep prices down to increase circulation and maximize advertising revenue. *See Khan*, 118 S. Ct. at 282 (citing BORK, *supra* note 60, at 281–82). For a detailed economic analysis of the successive monopoly phenomenon, see *infra* notes 160–68 and accompanying text. In a subsequent passage, the Court noted that the *Albrecht* rule could "exacerbate problems related to the unrestrained exercise of market power by monopolist-dealers" and "may actually harm consumers and manufacturers." *Khan*, 118 S. Ct. at 283. This does not appear to be an independent point, but rather an alternative way of explaining that maximum resale price fixing usually benefits consumers.

142 *See Khan*, 118 S. Ct. at 281.

143 *Id.* at 283.

144 *See id.* at 282–83; 7 PHILLIP AREEDA, ANTITRUST LAW ¶ 1635 (1989); PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 729.7 (1996 Supp.); Blair & Lang, *supra* note 84, at 1034; Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886, 907 (1981); Lopatka, *supra* note 60, at 60; *see also supra* notes 11–14 and accompanying text.

145 *Khan*, 118 S. Ct. at 283. Of the adverse consequences specified, the Court seemed most impressed by the possibility that maximum resale price agreements may mask minimum resale price arrangements, "which remain illegal per se." *Id.* The Court's response was that such arrangements can be punished under the rule of reason, but was careful to note that the other asserted consequences could also be so addressed.

tice.[146] The Court rejected Khan's argument that those seeking repeal of the *Albrecht* rule bear the burden of proving that the rule has distorted the market.[147] It observed that *Albrecht* relied only on hypothetical effects and that, even though suppliers have fashioned schemes to avoid the rule, the hypothesized effects have not materialized. In these circumstances, the Court found, those who would retain the rule bears the burden of justifying it, and they had failed to do so. In addition, the Court rejected the claim that *Albrecht* should be preserved because Congress, despite legislative proposals that might have affected the rule, had not acted to rescind it.[148]

Lastly, the Court paid homage to the importance of stare decisis in establishing the rule of law. It observed that adherence to precedent is "the preferred course,"[149] but that the principle "is not an inexorable command."[150] In the antitrust area, the Court has a responsibility to adapt the law "to changed circumstances and the lessons of accumulated experience," for "Congress 'expected the courts to give shape'" to the Sherman Act's broad mandate.[151] Hence, the Court has on occasion reversed an antitrust doctrine, including in *Sylvania*.[152] The Court found that later cases had so eroded the founda-

146 *Id.* (observing that *Albrecht* has little or no relevance to ongoing enforcement of the Sherman Act and that "neither the parties nor any of the amici curiae have called our attention to any cases in which enforcement efforts have been directed solely against the conduct encompassed by *Albrecht*'s per se rule").

147 *See id.* at 283–84.

148 The Court characterized as "misplaced" Khan's reliance on *Toolson v. New York Yankees, Inc.*, 346 U.S. 356 (1953) (per curiam), and *Flood v. Kuhn*, 407 U.S. 258 (1972). *Khan*, 118 S. Ct. at 284. In both of these cases, the Court refused to reverse the odd conclusion in *Federal Baseball Club v. National League*, 259 U.S. 200 (1922), that the business of professional baseball is not subject to the Sherman Act. The Court reached its conclusion in the latter cases partly on the ground that, despite proposals to do so, Congress had not acted to subject professional baseball to the antitrust laws in the decades following *Federal Baseball Club*. The *Khan* Court called these decisions "clearly inapposite." *Khan*, 118 S. Ct. at 284. Moreover, the Court found that the significance of legislative proposals regarding price fixing was ambiguous, given that they provided neither clear support for nor denunciation of the *Albrecht* rule. *See id.*

149 *Khan*, 118 S. Ct. at 284 (quoting Payne v. Tennessee, 501 U.S. 808, 827 (1991)).

150 *Id.* at 284 (quoting *Payne*, 501 U.S. at 828).

151 *Id.* (quoting National Soc. of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978)).

152 *Id.* The Court also cited *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), where the Court held that a parent and its wholly-owned subsidiary are incapable of conspiring for purposes of section 1 of the Sherman Act, thereby overturning a principle that had apparently been established in earlier cases. And it cited *Tigner v. Texas*, 310 U.S. 141, 147 (1940), where the Court rejected the argument that

tion of *Albrecht* that "there is not much of that decision to salvage."[153] Besides, no case reaching the Court since *Albrecht* had involved pure vertical maximum price fixing, so the rule of that case was not deeply embedded in Supreme Court precedent.[154]

In concluding, the Court emphasized that vertical maximum price fixing is not per se *lawful*. Instead, it instructed, the practice, "like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason. In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct."[155]

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a state antitrust law was unconstitutional because it subjected industrial but not agricultural combinations to criminal penalties and explicitly overruled *Connolly v. Union Sewer Pipe Co.*, 184 U.S. 540 (1902).

153 *Khan*, 118 S. Ct. at 285.

154 *See id.*

155 *Id.* Judge Posner had found that the plaintiff would lose under the rule of reason, but the Court nevertheless remanded the case to the appellate court for reconsideration in light of its decision. *See id.* The Court believed that the appellate court's observation might have been colored by the existence of the *Albrecht* rule and that the lower court should have an opportunity to consider the case with the knowledge that the rule of reason applies. *See id.*

On remand, Khan abandoned his claim of illegal vertical maximum price fixing, but renewed his claim that his arrangement with State Oil constituted per se illegal minimum resale price maintenance. *See* Khan v. State Oil Co., 143 F.3d 362, 363 (7th Cir. 1998). He argued that, because State Oil would not lower its wholesale price to preserve the margin between wholesale price and a retail price lower than that suggested by State Oil, and because he could not afford as a practical matter to earn a lower margin, he was in effect prevented from selling below the suggested price. *See id.* Judge Posner called the argument "frivolous," observing that a supplier has no antitrust duty to reduce his price to a retailer in order to preserve a particular margin. *Id. See also supra* note 107. Khan also argued that he could not make up any lost margin on gasoline that he sold below the suggested price by selling other grades above the suggested price, for that would have violated the contract. The court responded that the argument "is flatly inconsistent with the Supreme Court's decision, for it would convert every maximum price-fixing case into a minimum price-fixing case." *Khan*, 143 F.3d at 363. The court paused only to consider Khan's claim that the fact that Khan was required to buy gasoline only from State Oil somehow made the other features of the arrangement illegal. *See id.* The court noted that Khan had not described the terms of the contract bearing on the effective duration of exclusivity, but concluded that, in the absence of any claim of collusion among suppliers, a retailer could seek out a supplier who wanted to pursue a low-price strategy. Consequently, Khan had not offered evidence of any adverse effect on the competitive pricing of gasoline. *See id.*

IV. An Economic Analysis of Maximum Resale Price Restraints

A. *The Successive Monopolies Problem*

In order to better understand the economic irrationality of the *Albrecht* rule, it is useful to examine the motivation for maximum resale price fixing. Economic analysis reveals that consumers benefit from the practice. Assuming that consumer welfare is the primary concern of antitrust, one is driven to the conclusion that *Khan* was long overdue.

Suppose that, because of patent protection, only a single producer makes widgets; in other words, a firm has a perfectly legal monopoly in the production of widgets. From the standpoint of antitrust policy, it is important that the monopoly in production is legal; otherwise the correct approach would be to challenge that monopoly. The manufacturer sells its widgets to a distributor that has monopoly power in its market. This retail market power may arise because the manufacturer has granted an exclusive distributorship in a local market. In this event, the market structure is one of *successive monopoly*.[156] Maximum price restraints arise almost exclusively in markets where there is some element of successive monopoly, that is, where there is market power at the production stage and independent market power at the distribution stage.[157] As the subsequent analysis makes clear, consumers fare worse in this market structure than they do when a single, integrated firm has a monopoly of both production and distribution.

Identifying the sources of monopoly power in the successive monopoly environment can be instructive, for the origins are not immediately apparent in some of the factual contexts addressed by courts. For our purposes, monopoly power means simply the ability profitably to price above marginal cost. Stated otherwise, the monopolist faces a negatively sloped demand; the degree of market power does not affect the essential economic incentives. So understood, monopoly power in the upstream market may result from a number of conditions. As hypothesized above, for example, the firm may have a product monopoly protected by patent, copyright, or similar laws. Or, consumers may exhibit brand preference for a differentiated product. That may have been the basis of ARCO's market power, and Judge Posner spec-

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156 A full understanding of successive monopoly dates to at least Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. Pol. Econ. 347 (1950). *See also* Fritz Machlup & Martha Taber, *Bilateral Monopoly, Successive Monopoly, and Vertical Integration*, 27 Economica 101 (1960).

157 See any standard microeconomics text, for example Robert S. Pindyck & Daniel L. Rubinfeld, Microeconomics 336–39 (4th ed. 1997).

ulated that it might have underlaid State Oil's power.[158] Alternatively, a market may be able to support only one supplier of a relatively undifferentiated product. For instance, in *Albrecht*, perhaps only one newspaper could survive in the relevant geographic market. Then, too, the upstream firm may acquire monopoly power by simple ingenuity and innovation, unprotected by legal entry barriers. These sources of monopoly power are legitimate and unobjectionable on antitrust grounds. Of course, upstream monopoly power may also result from collusion or anticompetitive exclusion. In that case, the acquisition of monopoly power can be attacked independently; use of maximum vertical price fixing is largely irrelevant.

The downstream monopoly power is typically created by the upstream firm and is a function of the upstream monopoly. The supplier permits only one or a limited number of dealers to distribute its product in a given area, and the monopoly power enjoyed by the upstream firm is thereby transferred to the downstream firm. A supplier might choose to confer distribution monopolies because the service may exhibit economies of scale. In *Albrecht*, for example, the publisher might have granted carriers exclusive territories because newspaper delivery has natural monopoly characteristics in very small areas. A supplier might also confer downstream monopoly power because optimal product promotion requires dealer investments, and the dealer will resist making them if it is subject to free riding; limiting competition among dealers minimizes the risk of free riding and therefore encourages demand-increasing investments by dealers. This was the scenario envisioned by Judge Posner in *Khan*.[159]

In *Khan*, however, there was another potential source of downstream market power. Khan's service station might have had loca-

158 *See Khan*, 93 F.3d at 1362 (observing that Union 76 may be "a sufficiently distinctive and popular brand to give the dealers in question a modicum of monopoly power").

159 *See id.* (suggesting that State Oil might have limited competition between its dealers "to encourage . . . dealer services"). The dealer services explanation of maximum vertical price fixing assumes that the supplier imposes a cap on resale prices to prevent dealers from "exploiting [their] monopoly power fully." *Id.* One should however note that, by conferring downstream monopoly power and constraining price, the supplier may not achieve the desired result. The dealer may skimp on service and earn monopoly rents at the fixed price. Given this possibility, the supplier may have to ensure that the desired dealer services are stipulated contractually and then police the contract. *Cf.* Lester G. Telser, *Why Should Manufacturers Want Fair Trade II?*, 33 J.L. & ECON. 409 (1990) (criticizing some theories of minimum resale price fixing on the ground that, unlike the pure dealer services explanation, which relies upon competition among dealers to induce them to provide optimal services, they do not free the supplier from policing contractual service commitments).

tional advantages that offered the prospect of economic rents in the sale of any kind of gasoline. In that event, the owner of the station would have an interest in exploiting the monopoly power incident to the scarce location. But Khan did not own the station—State Oil did, and it leased the station to Khan. The dealer, therefore, might have had monopoly power flowing from consumer preference for the Union 76 brand or from the valuable location of the station. Either way, it was the creation of State Oil, and State Oil would have had an incentive to prevent Khan from reaping the economic rewards to which it was entitled.

Notice that the existence of market power at the retail level is necessary to explain the efficiency-enhancing use of a resale price ceiling in a successive monopoly environment, and the leading asserted anticompetitive effects of the practice assume downstream market power as well. Thus, for example, the suggestion that a dealer could expand output and increase profits by providing additional, valuable services that cannot be offered at the constrained retail price assumes that the dealer faces a downward-sloping demand curve. The additional services would shift that curve to the right. To put the point differently, the possibility that the supplier would set a resale price ceiling below the market-clearing price in a perfectly competitive downstream market is silly—at least it is sufficiently unlikely to deserve no place in formulating antitrust policy. Whether one believes that vertical maximum price fixing is efficient or somehow inefficient, then, there ought to be no serious disagreement that dealers subject to the price constraint have some monopoly power for some reason.

Under conditions of successive monopoly, whatever the source of the power, the manufacturer must take into account the profit maximizing behavior of the distributor. The distributor will maximize its profit in the usual way by selling that quantity where its marginal revenue equals its marginal cost. In this endeavor, the distributor must have widgets to sell. It demands widgets for resale—not for its own use. As a result, the distributor's demand is derived from the consumer demand for widgets. It is this derived demand that the manufacturer faces. The analysis, then, requires that we find the derived demand for the manufacturer.

In Figure 1, the consumers' demand for widgets is represented by *D* and the associated marginal revenue is represented by *MR*.[160] This, of course, is the demand that the distributor faces. The derived de-

160 In this example, the consumers' demand is $P = 14 - 0.02Q$ and the associated marginal revenue is $MR = 14 - 0.04Q$. The specific numerical example is traced through the analysis to make the general analysis more concrete.

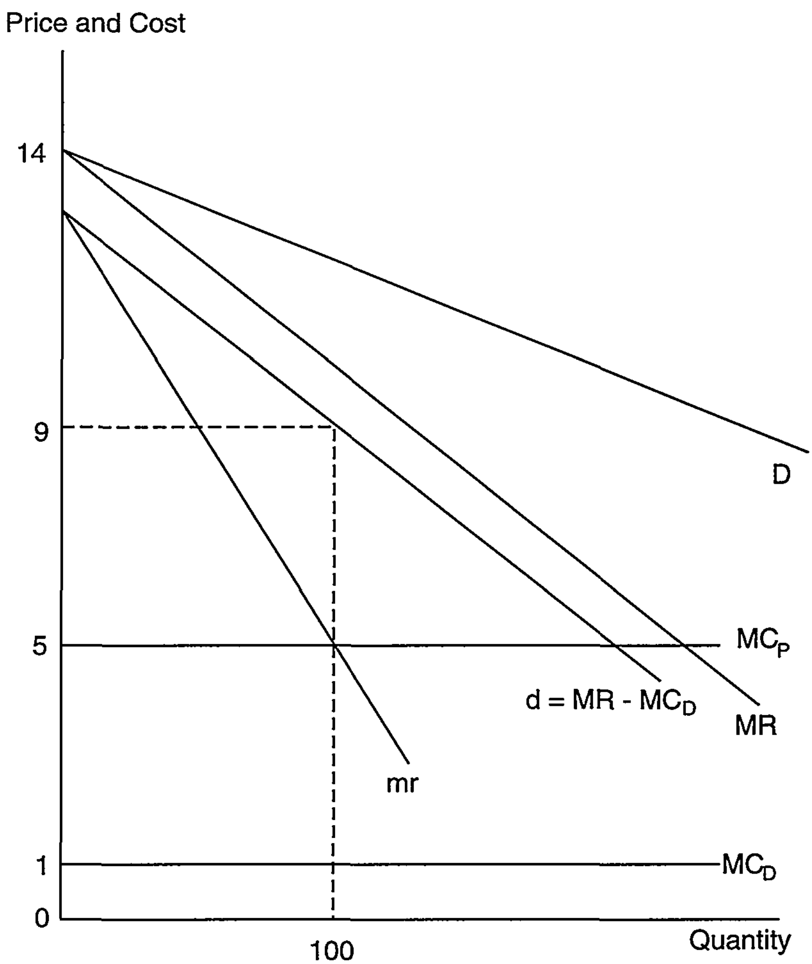

Figure 1

mand of the distributor can be ascertained from the distributor's profit-maximizing calculus. As we said above, the distributor will maximize its profits by equating marginal revenue (*MR*) to its marginal cost. The distributor's marginal cost equals the marginal cost of goods sold, which is the wholesale price (P_w) charged by the manufacturer, plus the marginal cost of performing the distribution function. The latter is shown in Figure 1 as MC_D. Thus, the distributor will sell that quantity where $MR = P_w + MC_D$. Rearranging this condition reveals the derived demand: $P_w = MR - MC_D$. Given the profit-maximizing behavior of the distribution monopolist, the maximum price that the manufacturer can charge for any specific quantity is the difference between the marginal revenue at that quantity and the distributor's marginal cost of performing the distribution function. In Figure 1, we have shown the derived demand as $d = MR - MC_D$, and the associated marginal revenue is shown as *mr*.[161]

The manufacturer maximizes its profits by producing that quantity where marginal revenue (*mr*) equals the marginal cost of production (MC_P): $mr = MC_P$. As shown in Figure 1, the profit-maximizing quantity is 100 widgets.[162] The profit maximizing price that corresponds to an output of 100 is found by substituting 100 for Q in the derived demand. In this example, the optimal wholesale price is $9.[163]

Once the manufacturer selects a wholesale price, the marginal cost of the distributor is determined, for the distributor's marginal cost is P_w plus MC_D. Figure 2 is precisely the same as Figure 1, except for the addition of the distributor's marginal cost. The distributor will maximize its profits by selling that quantity where its marginal revenue (MR) equals its marginal cost: $MR = P_W + MC_D$. In our example, the marginal cost is $10, the optimal output is 100, and the optimal price to consumers is $12.[164]

The profits of the producer and the distributor are relatively easy to show. For the producer, its profit (Π_P) is the difference between price and cost times the quantity sold: $\Pi = (P_W - MC_P)Q$. In our example, this amounts to $400.[165] For the distributor, its profit (Π_D) is calculated in a similar fashion: $\Pi_D = (P - P_W - MC_D)Q$. In this example, the distributor's profit is $200.[166] Thus, the total profit when there is successive monopoly is $\Pi_P + \Pi_D$, or $600.

This market structure is undesirable from the manufacturer's perspective because it is possible to generate more profit. We can see

161 The derived demand facing the manufacturer is $P_w = MR - MC_D$. Assuming that MC_D = $1, we can use the results from *supra* note 160 to write $P_w = 14 - 0.04Q - 1$ or $P_w = 13 - 0.04Q$. In this case, the marginal revenue will be $mr = 13 - 0.08Q$.

162 In this example, we have assumed that the marginal cost of production is $5. Equating marginal revenue from note 161 *supra* to the marginal cost of production, $13 - 0.08Q = 5$, and solving for Q yields the optimal output of 100.

163 The derived demand is $P_W = MR - MC_D$ or $P_W = 13 - 0.04Q$. Consequently, when $Q = 100$, $P_W = 9$.

164 Since the wholesale price is $9 and the marginal cost of performing the distribution function is $1, the distributor's marginal cost is $10. The distributor sells the quantity where $MR = P_W + MC_D$ or $14 - 0.04Q = 10$, which yields an optimal quantity of 100. Substituting $Q = 100$ into the demand function yields $P = 14 - 0.02(100) = 12$.

165 Substituting $9 for P_W, $5 for MC_P, and 100 for Q in $\Pi_P = (P_W - MC_P)Q$ we have $\Pi_P = (9 - 5)100 = 400$.

166 Substituting $12 for P, $9 for P_W, $1 for MC_D, and 100 for Q in $\Pi_D = (P - P_W - MC_D)Q$, we have $\Pi_D = (12 - 9 - 1)100 = 200$.

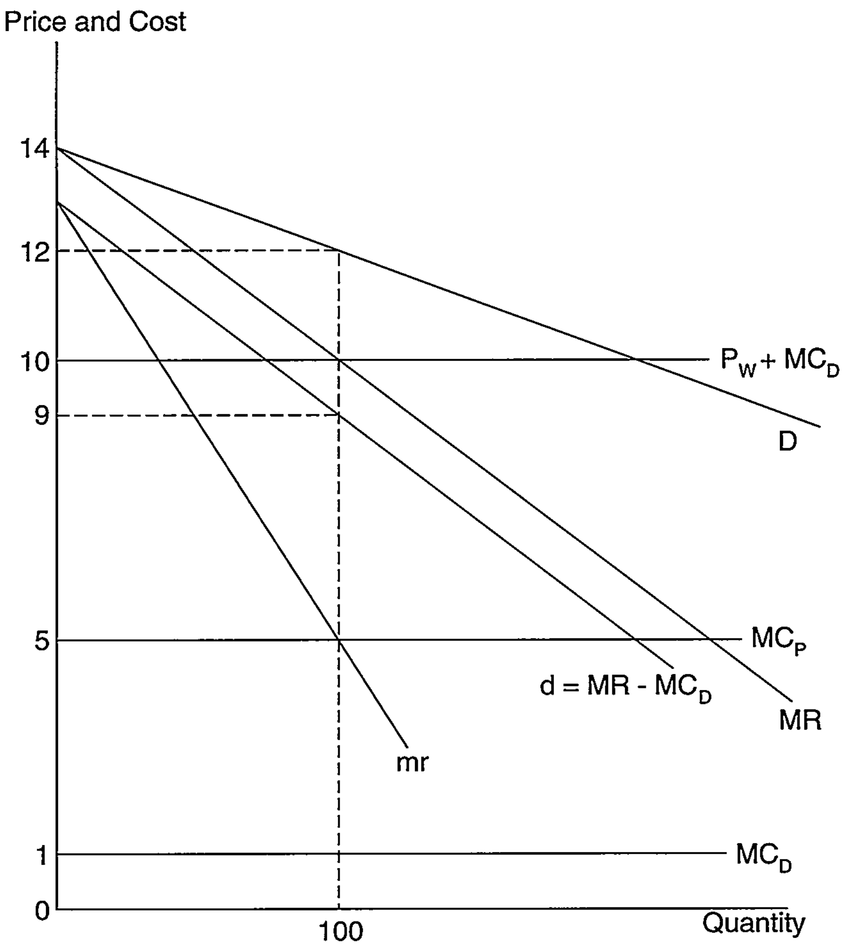

Figure 2

this by considering what would happen if the manufacturer were vertically integrated. By this, we mean that the manufacturer would produce the widgets and perform the distribution function itself. In that case, the manufacturer would produce and distribute that quantity of widgets where the marginal revenue equals the marginal cost of production plus the marginal cost of distribution: $MR = MC_P + MC_D$. In Figure 3, we have reproduced Figure 2, but we have added the marginal cost of production and distribution ($MC_P + MC_D$). In the example, this marginal cost is $6 and the profit-maximizing output is 200.[167] At an output of 200, the corresponding profit-maximizing price is $10.[168] The manufacturer's profit is given by $\Pi = (P - MC_P - MC_D)Q$, which is $800.

In a successive monopoly situation, vertical integration leads to an expansion of output, a reduction in price, and an increase in total profits. In spite of the fact that price is lower, the profit of the vertically integrated monopolist is larger than the sum of the profits earned by a production monopolist and a separate distribution monopolist. This is the inefficiency associated with the successive monopoly. Thus, one might expect vertical integration to occur under these structural conditions.

A cat, however, can be skinned in more than one way. The results of vertical integration can be achieved through contractual alternatives, and one of these methods is maximum resale price fixing.[169] The manufacturer can determine the optimal price from its perspective. In this case, that price is $10. It agrees to sell its widgets to an independent distributor on the condition that the distributor not charge more than $10. In that event, the manufacturer will sell 200 widgets at a price of $9 to the distributor. This wholesale price will permit the distributor to sell 200 widgets at a retail price of $10 because the marginal cost to the distributor is the wholesale price ($9) plus the marginal cost of distributing the widgets ($1). Thus, the results of maximum resale pricing are the same as those of vertical integration: $Q = 200$ and $P = \$10$. The manufacturer's profit is $(P_W - MC_P)Q = (9 - 5)200 = \$800$. The distribution monopolist is forced to behave as a competitive firm would, namely, selling that output where price equals marginal cost. As a result, the distributor's profit is zero: $\Pi_D = (P - (P_W + MC_D))Q = 0$, because $P = P_W + MC_D$. This is not to say that the distributor just barely breaks even. But the distributor is limited to a competitive return, which is already reflected in its costs.

To recognize that maximum resale price fixing is a ready economic substitute for vertical integration does not imply that a prohibition on the pricing method is costless. One might be tempted to

167 Given the marginal revenue, $MR = 14 - 0.04Q$, and marginal cost, $MC = 5 + 1 = 6$, optimal output is found by solving $14 - 0.04Q = 6$ for Q, which yields a profit maximizing quantity of 200.

168 The profit maximizing price is found by substituting $Q = 200$ into the demand function: $P = 14 - 0.02Q$ or $P = 14 - 0.02(200) = 10$.

169 For extensive examinations, see ROGER D. BLAIR & DAVID L. KASERMAN, LAW AND ECONOMICS OF VERTICAL INTEGRATION AND CONTROL (1983); FREDERICK R. WARREN-BOULTON, VERTICAL CONTROL OF MARKETS: BUSINESS AND LABOR PRACTICES (1978).

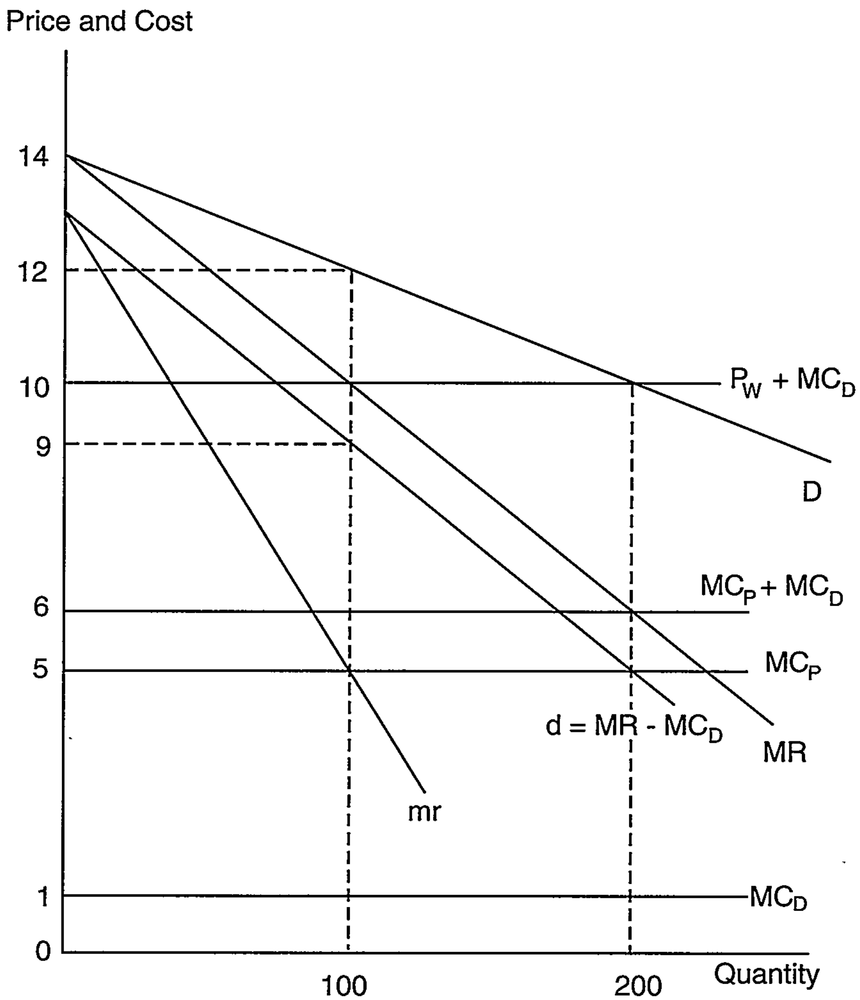

Figure 3

conclude that, if vertical integration or other contractual devices are legal and effective alternatives, then the *Albrecht* rule did no harm. Indeed, Justice O'Connor in *Khan* observed that firms "appear to have fashioned schemes to get around the *per se* rule against vertical maximum price fixing."[170] But good substitutes are rarely perfect substitutes, and the costs associated with using a less desirable alternative to achieve a beneficial end are borne by society.

Clearly the manufacturer employs maximum resale price restraints in order to improve its profits. Indeed, in our numerical example, its profits double. But the manufacturer's interests and those

170 State Oil v. Khan, 118 S. Ct. 275, 283 (1997).

of consumers coincide. We have already seen that quantity doubles from 100 to 200 widgets and that price to the consumer falls from $12 to $10. One would suspect that consumer welfare rises as a consequence, and the suspicion is borne out. In the successive monopoly case described in Figure 2, net consumer surplus (*CS*) is the area below the demand curve above the price. In our numerical example, this area will be $CS = \frac{1}{2}(14 - 12)100 = \$100$. When maximum resale pricing is employed, consumer surplus rises substantially: $CS = \frac{1}{2}(14 - 10)200 = \$400$. Thus, the maximum resale price restraints lead to increased output, reduced prices, and increased consumer welfare.

Recall that in *Khan*, State Oil owned the service station, and the station might have been located so advantageously as to generate economic rents. In that case, if State Oil had been vertically integrated, it would have set a retail price that maximized its profits, as the above analysis demonstrates. That price might have exceeded the price charged by stations in inferior locations. But absent a price ceiling, a lessee-dealer would have an incentive to charge a higher price, one that increases his profits at the expense of State Oil and consumers. Again, State Oil might have achieved similar results without capping resale prices through contractual provisions, but these devices may have been relatively costly, even prohibitively so. At any rate, State Oil could not maximize its profits by simply demanding a percentage of the dealer's sales revenue. That kind of royalty would function as a tax on the dealer. The dealer would take into account the cost of the royalty in setting retail price and would price above the level that would maximize the station owner's profits.[171]

The upshot of this analysis is that the *Albrecht* rule injured consumer welfare. Protecting the interests of the distributors at the expense of the consumer was economically perverse.

B. The Monopsony Hypothesis

Justice Harlan and Judge Posner both suggested that one might consider the retailer's mark-ups, or the difference between the wholesale and the retail prices, as the price the supplier pays for distribution services.[172] Then, a supplier with monopsony power might impose a

171 *See* Blair & Kaserman, *supra* note 169, at 58–68. State Oil in such a case could be likened to the owner of a valuable patent who, for reasons of efficiency, licenses a single firm to use the patent. In these circumstances the patentee cannot easily prevent the licensee from siphoning off monopoly profits, and injuring consumers in the process, without capping output price. *See generally* Ward S. Bowman, Jr., Patent and Antitrust Law 122 (1973).

172 *See* Albrecht v. Herald Co., 390 U.S. 145, 164–65 (1968) (Harlan, J., dissenting); Khan v. State Oil Co., 93 F.3d 1358, 1361 (7th Cir. 1996); *see also* Easterbrook,

resale price ceiling to drive its dealers' margins below the competitive price for distribution services, thereby reducing its cost of distribution; analogously, competing suppliers that collectively have power to affect the market price of distribution services might agree to impose a resale price cap for the same reason. The latter case is an example of a collusive monopsony, and generally an agreement among competitors not to compete in the purchase of goods or services is a per se violation of section 1 of the Sherman Act.[173]

The exercise of monopsony power, however, whether unilateral or collusive, is not apt to be the explanation for maximum resale price fixing. A model of monopsony will illustrate why this is so. In Figure 4, the demand and supply of distribution services are depicted by *D* and *S*, respectively. Assuming a substantial number of buyers and sellers, the intersection of supply and demand will determine the competitive price and quantity, which are P_1 and Q_1, respectively. A buyer or group of colluding buyers with monopsony power will reduce the quantity of distribution services purchased to Q_2, where the marginal factor cost (*MFC*) intersects the demand curve.[174] The price of the distribution services is determined by the supply curve and, therefore, depressing the quantity to Q_2 results in a decrease in the price from P_1 to P_2.[175]

This is an inefficient result. The effect of the arrangement is to reduce quantity and price below the competitive levels. But this outcome depends crucially upon the assumption that the supply of distribution services facing the firm or colluding group of firms accused of exploiting monopsony power is positively sloped. In the real world,

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supra note 144, at 888 & n.7 (noting that *Albrecht* can be viewed as a monopsony problem, but concluding that such an interpretation is implausible).

173 *See supra* note 38 and accompanying text. For a more extensive examination of the law and economics of monopsony, see ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY: ANTITRUST LAW AND ECONOMICS (1993).

174 When a single buyer faces a positively sloped supply curve for an input, say, labor (L), its profits (Π) function can be written as $\Pi = PQ - w(L)L - rK$, where P and Q denote price and output, respectively, w(L) is the wage rate, which depends on the amount of labor hired, and r is the price of capital (K). Then, in order to maximize profits, the monopsonist must hire labor to the point where $M\Pi/ML = P(MQ/ML) - [w + L(dw/dL)] = 0$. The first term, $P(MQ/ML)$, is the value of the marginal product of labor, which is the demand. The second term, $w + L(dw/dL)$, is the marginal factor cost. The marginal factor cost is the incremental effect of a small increase in employment on the total wage bill. Note that the marginal factor cost exceeds the wage because dw/dL, the slope of the supply curve, is positive and, therefore, $w + L(dw/dL) > w$, as shown in Figure 4.

175 The effect of this exercise of monopsony power is to reduce the monopsonist's average cost. This, of course, will increase its profits, which explains why a monopsonist will reduce employment.

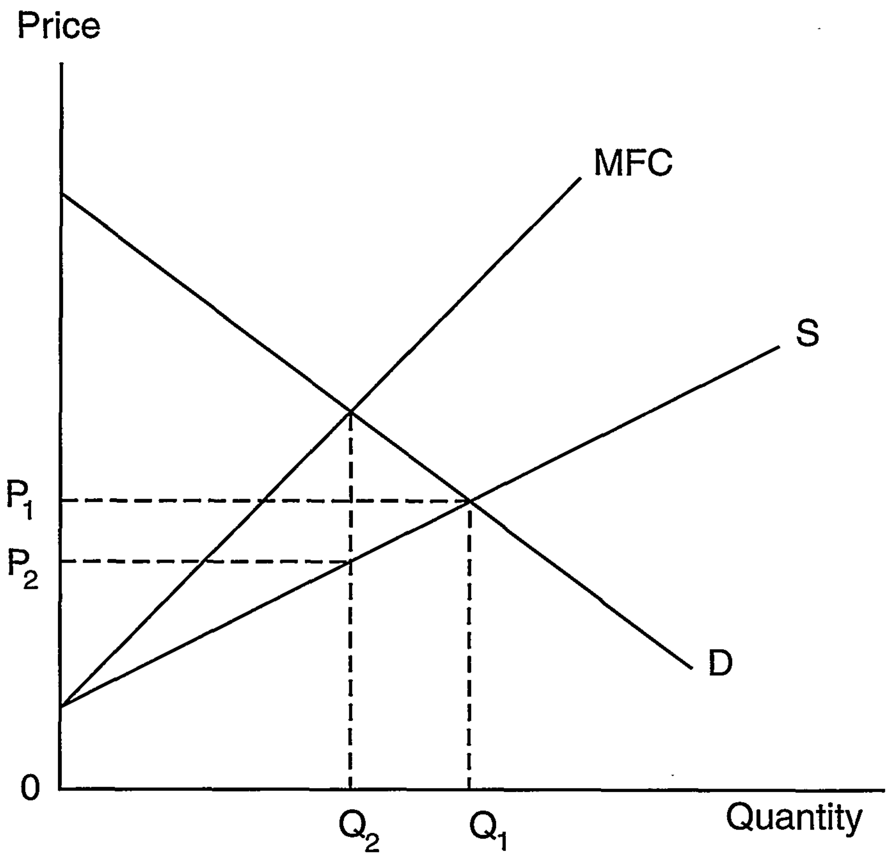

Figure 4

we surmise that rarely, if ever, will a single buyer or any plausible conspiring group of buyers of distribution services confront a positively sloped supply curve. Notice that, if the buyers in question face a horizontal supply curve, that curve will coincide with the marginal factor cost curve, and the buyers will not be able to affect price by reducing the quantity purchased. A positively sloped supply curve implies that the resources necessary to provide the services in question are specialized to the needs of the buyers under consideration. Thus, if the buyer demanded less, the supplier would not easily be able to shift to an alternative buyer. The resources necessary to provide distribution services, however, tend not to be specialized. If a single purchaser of some kind of distribution services attempted to depress price, dealers would switch to other buyers desiring the same kind of services; if a group of firms in the same industry conspired to offer a depressed price for distribution services, dealers would switch to buyers in other industries.[176] A multi-industry buyers' cartel large enough to have monopsony power in the purchase of distribution services seems fanciful.

For example, in *Albrecht*, the newspaper publisher needed home-delivery services. No specialized skills are needed to deliver newspapers, which means that newspaper distributors come from the general labor pool. Thus, the newspaper publisher would be just one among many employers. These distributors, therefore, could easily shift from newspaper delivery to some other unskilled occupation. Consequently, from the publisher's perspective, the supply curve is flat at the competitive wage; that is, the wage that the publisher must pay is determined by the market and not by how much the publisher hires. Under these circumstances, the marginal factor cost and the wage rate coincide, and the publisher has no monopsony power. The publisher, therefore, would be unable to push the price it paid for distribution services below the competitive level.

Much the same can be said about the services of independent gasoline retailers, the services involved in *ARCO* and *Khan*. The gasoline supplier drew its dealers from a large pool of potential franchisees. In attracting franchisees, both ARCO and State Oil competed with scores of other franchisors both in and out of the gasoline industry. Any attempt to pay less than a competitive rate for gasoline retailing services would be futile. Of course, the dealers in these cases competed with thousands of actual and potential franchisees. Again, from their perspective, the defendants in both cases confronted horizontal distribution services supply curves.

Kiefer-Stewart is the only case we know of that involved an agreement between ostensible competitors to impose a resale price ceiling. Justice Harlan and Judge Posner argued that *Kiefer-Stewart* can be distinguished from *Albrecht* because of this horizontal aspect; they suggested that only the arrangement in *Kiefer-Stewart* could appropriately be held unlawful per se, though neither was deciding that case. But once again, the distribution of liquor involves no obvious specialized skill, and so one would assume that a single distiller would have no monopsony power. For that matter, one would suspect that no two

176 Even though the market supply curve may have a positive slope, any single employer or even a group of employers is apt to be small relative to the total labor market. As a result, it behaves as a *price taker*. In other words, it considers the wage to be a market determined parameter. It will not consider the wage to be a function of *its* employment decision. Thus, from the firm's perspective the supply curve is flat and it has no monopsony power. *See generally* Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony and Antitrust*, 36 ANTITRUST BULL. 1 (1991); BLAIR & HARRISON, *supra* note 173.

distillers have monopsony power, and so if we indulge in the since-repudiated assumption that the affiliated distillers in *Kiefer-Stewart* were separate economic entities, they still would not likely have been able to exploit monopsony power. Indeed, even if all liquor distillers conspired to depress the price offered for distribution services, wholesalers would seem perfectly capable of selling their services to the manufacturers of other products.

We do not mean to suggest that agreements among competitors to impose maximum resale price ceilings on their distributors should be immune to antitrust attack.[177] But the argument for per se illegality is demonstrably weaker than it is in the case of other horizontal agreements to limit price competition. In the case of a naked agreement among sellers to fix price, for example, we assume that there is no efficiency-enhancing explanation; we make a similar assumption in the case of a collusive monopsony purchasing most inputs, such as, say, sugar beets. If there is no legitimate justification, the inference is strong that the cartel has market power.[178]

By contrast, if competitors who agree to impose maximum price constraints on their dealers are unlikely to have market power in the purchase of *distribution* services, then perhaps some legitimate justification explains their arrangement. In *Kiefer-Stewart,* for instance, the distillers were attempting to thwart a wholesalers' cartel.[179] Of course, the Supreme Court has said that competitors cannot successfully defend an agreement to restrict competition between themselves on the ground that it prevents some unlawful conduct.[180] But the undeniable economic reality is that the arrangement can benefit consumers, and prohibiting a restraint of trade that increases consumer welfare on the ground that it might have the opposite effect in other circum-

177 One could reasonably argue that horizontal agreements to impose maximum resale prices should be legal per se on the ground that few instances are likely to be anticompetitive, and the savings in litigation costs attendant to a rule of no liability would outweigh the efficiency loss associated with the anticompetitive occasions. *See infra* notes 179–82 and accompanying text. We do not go that far, however, because we believe that the reasonableness inquiry in this context is practical.

178 *See, e.g.*, Summit Health, Ltd. v. Pinhas, 500 U.S. 322, 339 (1991) (Scalia, J., dissenting) (observing that "the very existence of [a price fixing agreement] implies power over price" in the market where it occurs).

179 A similar justification was offered for purely vertical maximum price fixing in *Kestenbaum v. Falstaff Brewing Corp.*, 575 F.2d 564 (5th Cir. 1978). The supplier allegedly attempted to constrain resale prices in order to prevent wholesalers from conspiratorially raising prices. The court held that monopoly profits lost by the wholesalers were not antitrust damages.

180 *See, e.g.*, Fashion Originators' Guild of Am. v. FTC, 312 U.S. 457, 468 (1941).

stances ignores the fundamental purpose of antitrust law.[181] Indeed, if distributors collude to fix price, the only means of self-help their suppliers may have is to impose a resale price ceiling, for the suppliers likely would have no antitrust standing to maintain an antitrust action against them.[182] If horizontal agreements to impose maximum resale prices can in theory have either positive or negative effects on consumer welfare, a rule of per se illegality might nevertheless be appropriate if instances of negative effects greatly predominate, and the costs of distinguishing between the two are not worth the effort. Such empirical support, however, is nonexistent. The law's experience is limited to one reported case, and that was an example of consumer benefit.

We suggest, then, that horizontal agreements to impose resale price caps be subject to the rule of reason. Our suspicion is that few instances of these arrangements, either beneficial or harmful, are deterred by the current per se rule, and so a change to the rule of reason would likely have little effect. But we see no reason why courts could not identify at reasonable cost any instances of anticompetitive use of the practice. We readily acknowledge the frustrating vagueness that typically attends use of the rule of reason.[183] In most cases of horizontal agreements to fix maximum resale prices, however, the rule would entail a simple inquiry into whether the market for distribution services in the case at hand is so unusual that the upstream firms have monopsony power. The justification for per se illegality, therefore, is unconvincing.

Our analysis thus far has assumed that resources devoted to distribution are not specialized in an economically relevant sense. In the long run, that will almost invariably be true. In the short run, however, distribution services indeed may be specialized to a particular

181 *See* RICHARD A. POSNER, ANTITRUST LAW 209–10 (1976) (arguing that a boycott intended solely to prevent unlawful conduct should not be an antitrust violation).

182 *See* Page, *supra* note 69, at 1492–93 (arguing that suppliers of a cartel suffer antitrust injury but do not have antitrust standing to complain). Of course, suppliers in such a case might unilaterally impose resale price caps on their own dealers without agreeing to the vertical restraint, thereby avoiding liability. But they would run the risk that an agreement would be inferred from parallel conduct. *See generally* Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962). And unilateral action could be ineffective if the downstream cartel was economically able to cut off any individual supplier that imposed a resale price cap. Nevertheless, the possibility that unilateral imposition of a resale price ceiling could thwart a dealer's cartel reinforces the conclusion that *Kiefer-Stewart* did not involve a horizontal agreement in an economic sense.

183 *See generally infra* notes 192–94 and accompanying text.

industry or even an individual purchaser. One might then ask whether maximum vertical price fixing should be condemned on the ground that it may represent the exploitation of short-run monopsony power. The answer is no, and the reason inheres in the difference between monopsonistic exploitation and postcontractual opportunism.

In the monopsony model, no one is forced to provide services at a price below his or her reservation level. Because of the monopsonistic pursuit of profit, the quantity of services is depressed below the competitive level (Q_1) and the corresponding price falls below the competitive level (P_1) to the monopsony level (P_2). But these prices are dictated by the supply curve, which shows the quantities of services forthcoming at various prices. Each supplier receives at least her reservation price. There is no coercion here, in an economically meaningful sense.

Yet one might be concerned that the supplier may take advantage of the dealer to the extent that the dealer incurs unrecoverable costs to provide distribution services for this particular supplier. Suppose, for example, that a franchisee like Khan has committed resources to the specific venture. In the short run, Khan will continue in business as long as the price he receives exceeds his average variable cost. If the price is below his average total cost, he will experience losses, but he will minimize these losses by continuing in business provided that price exceeds average variable cost. Once committed, therefore, Khan can be abused by State Oil if State Oil squeezes Khan's margins enough to reduce price below average cost. In effect, Khan will earn a return on his investment in gasoline retailing below the competitive level. He will be a victim of postcontractual opportunism.

This kind of opportunism, however, is not an antitrust problem. Dealers typically can protect themselves against it by contract.[184] If a supplier breaches the contract, the dealer is entitled to contract reme-

184 Interestingly, Khan asserted a breach-of-contract claim along with his antitrust claim. He argued that he had a contractual right to earn a normal return on his investment by being allowed to maintain an appropriate margin between wholesale and retail prices. *See* Khan v. State Oil Co., 93 F.3d 1358, 1366 (7th Cir. 1996), *rev'd*, 118 S. Ct. 275 (1997). Khan claimed that contract was breached when State Oil suggested retail prices (and set wholesale prices to provide a margin of 3.25 cents) that were too high in light of competitive conditions. State Oil conceded its contractual commitment, but the appellate court found insufficient evidence to support the claim. *See id.* Of course, this claim had to do with the alleged inability to price below a suggested floor, not to price above a suggested ceiling. But the principle applies equally. Contract remedies can be obtained when a supplier breaches an obligation to permit the dealer to earn an agreed-upon return by setting a resale price ceiling too low.

dies, and one might argue that no harm is done by holding the supplier liable for antitrust penalties to boot. But such a legal result would be predictably inefficient so long as the remedy the plaintiff can obtain exceeds the harm suffered. In that case, the dealer has a perverse incentive to provoke the breach and to hold-up the supplier, and the supplier has an incentive to invest in socially costly and unnecessary measures of self-protection. To the extent that the plaintiff could obtain both contract and antitrust damages, the supplier's potential liability is obviously socially excessive. But of course, even antitrust sanctions alone as a remedy for the contractual breach would likely be excessive, for unlike contract damages, antitrust damages are trebled.

Further, dealers enjoy the protection afforded by inexorable market forces. If State Oil persisted in abusing its franchisees, they would fail and no one would want to take their place. Unless State Oil wants to integrate vertically and perform the distribution function itself, it must make being a franchised lessee dealer financially attractive. Postcontractual exploitation is seldom if ever a viable long-run strategy, and the antitrust laws ought to have no role to play unless a practice threatens to inflict significant and sustained economic harm.

To be sure, the Supreme Court in *Eastman Kodak Co. v. Image Technical Services, Inc.*[185] held that a seller can violate the antitrust laws by exploiting the monopoly power that results from high switching and information costs: once a purchaser is "locked-in" to a particular piece of equipment, for example, the seller can demand a premium for aftermarket products, such as repair parts and services, up to the cost the purchaser would bear in switching to another brand of equipment if the purchaser cannot anticipate the full cost of the package of products at the time she buys the equipment. Without in any way endorsing an antitrust rule that addresses a contractual problem,[186] it

185 504 U.S. 451 (1992) (holding that the manufacturer of equipment can violate the antitrust laws by denying unique repair parts to independent service providers, thereby forcing equipment owners to procure repair service from the equipment manufacturer, even when the firm has no market power in the sale of equipment).

186 For commentary critical of *Kodak*, see BORK, supra note 60, at 436–38; Roger D. Blair & Jill H. B. Herndon, *Restraints of Trade by Durable Good Purchasers*, 11 REV. INDEP. ORG. 339 (1996); Herbert Hovenkamp, *Market Power in Aftermarkets: Antitrust Policy and the* Kodak *Case*, 40 UCLA L. REV. 1447 (1993); Michael S. Jacobs, *Market Power Through Imperfect Information: The Staggering Implications of* Eastman Kodak Co. v. Image Technical Services *and a Modest Proposal For Limiting Them*, 52 MD. L. REV. 336 (1993); Benjamin Klein, *Market Power in Antitrust: Economic Analysis after* Kodak, 3 SUP. CT. ECON. REV. 43 (1994); John E. Lopatka, *The Court's Economic Gibberish*, LEGAL TIMES, July 27, 1992, at S34. For contrary views, see Severin Borenstein et al., *The Economics of Customer Lock-In and Market Power in Services*, *in* THE SERVICE AND PRODUC-

does not support outlawing vertical maximum price fixing. The return the dealer expects for performing distribution services is the very heart of the transaction with her supplier. It does not concern some aftermarket service that a party would supposedly neglect or be unable to take into account at the time of committing to a particular vendor. The dealer has both a keen incentive and the ability to protect herself contractually from subsequent opportunism on the part of the supplier.

V. Implications of *Khan*

A. *The Demise of* Albrecht

Critical analysis tends to blur a judicial decision's positive contributions. Lest they go unappreciated, let us emphasize what *Khan* accomplished. Foremost, the Court repudiated a bad rule, despite the mounting pressure of stare decisis. The decision, moreover, is a testament to the value of academic scholarship. Years of scholarly criticism influenced the judicial mind in this case, and the beneficiary is the economy.[187]

Just what the measure of these benefits are, however, is difficult to estimate. As we mentioned earlier, and as Justice O'Connor observed, suppliers and dealers surely found ways to accomplish the purposes of maximum resale price fixing without running afoul of *Albrecht*.[188] Tellingly, however, Justice O'Connor cited no authority for her observation, and though we can point to theoretical alternatives and even to a few instances in which an alternative was used in practice,[189] we have no sense of the number of times a device was used

tivity Challenge (P. Harker ed., 1994); Warren S. Grimes, *Antitrust Tie-In Analysis After* Kodak*: Understanding the Role of Market Imperfections*, 62 Antitrust L.J. 263 (1994); Robert H. Lande, *Chicago Takes It on the Chin: Imperfect Information Could Play a Crucial Role in the Post-*Kodak *World*, 62 Antitrust L. J. 193 (1993); Steven C. Salop, *Exclusionary Vertical Restraints Law: Has Economics Mattered?*, 83 Am. Econ. Rev. 168 (1993).

187 Justice O'Connor not only cited a number of articles in the course of her opinion, but she noted that scholarly "criticism of [*Albrecht*'s theoretical justifications for a per se rule] abounds" and explicitly stated that the Court's analysis was informed in part by "a considerable body of scholarship discussing the effects of vertical restraints." State Oil Co. v. Khan, 118 S. Ct. 275, 282 (1997). *See also id.* at 283 (noting that the Court reached its conclusion after "reconsidering *Albrecht*'s rationale and the substantial criticism the decision has received"); *id.* at 285 (remarking that "*Albrecht* has been widely criticized since its inception").

188 *See id.* at 283.

189 Theoretical alternatives are surveyed and some cases employing them are identified in Roger D. Blair & Amanda K. Esquibel, *Maximum Resale Price Restraints in*

merely to circumvent *Albrecht*. Presumably, most times an alternative was tried, it was not challenged, for the purpose of an alternative is to avoid offending the law. Nor can we predict the marginal inefficiency of the substitute practice, the true opportunity cost of the per se prohibition. Then, too, we know that some firms tried to engage in vertical maximum price fixing despite *Albrecht* and were punished for it, and we can assume that some firms simply surrendered, abandoning any attempt to achieve the purposes of the practice. Thus, the benefits of repealing the per se rule are difficult to gauge, but they are undeniable.

B. Antitrust Injury

Although these direct benefits of *Khan* are real, the most important contribution of the case may be indirect: *Khan* strengthened the antitrust injury doctrine without even mentioning it. Had the Court never issued its opinion in *ARCO*, lower courts might eventually have galvanized around the proposition that *Brunswick* implicitly disallowed private actions contesting vertical maximum price fixing. That would have limited the enforcement of the *Albrecht* rule to the federal agencies, if that, and they likely would have been unenthusiastic prosecutors.[190]

ARCO's message was clear, however. Dealers were constrained by a price ceiling and consumers could sue, so the specter of an antitrust injury doctrine cut loose from its economic mooring loomed. Lower courts were free to fashion definitions of antitrust injury that encompassed harms flowing from a host of practices and having nothing to do with consumer welfare. The antitrust injury doctrine serves to limit the pernicious effects of misguided antitrust rules, for it circumscribes the universe of potential enforcers. Additionally, it serves as a check

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Franchising, 65 ANTITRUST L. J. 157 (1996). Another example is *Ryoko Manufacturing Co. v. Eden Services*, 823 F.2d 1215 (8th Cir. 1987), where the supplier was able to constrain the dealers' prices by creating an agency relationship with the dealers, such that the supplier was not fixing maximum *resale* prices. In *Greene v. General Foods Corp.*, 517 F.2d 635 (5th Cir. 1975), the supplier attempted to pursue the same strategy but failed. The court held that dealers were purchasers, not agents.

190 The Court observed that "*Albrecht* has little or no relevance to ongoing enforcement of the Sherman Act," and it noted that neither the parties nor amici could identify any cases in which vertical maximum price fixing was attacked by government enforcers. *Khan*, 118 S. Ct. at 283. Recall that in his opinion in *Khan*, Judge Posner intimated that even the federal government might be precluded from challenging the practice if it failed to inflict antitrust injury. *See* Kahn v. State Oil, 93 F.3d 1358, 1364 (7th Cir. 1996). We doubt that most federal appellate courts would have taken that position, though.

on erroneous application of sound rules in ambiguous settings, for it can foreclose some plaintiffs from recovering when the court cannot tell whether a practice actually causes an inefficiency. Whether the doctrine could reliably perform these functions was put in doubt by *ARCO.* By repudiating *Albrecht,* the *Khan* Court did away with a substantive doctrine that was irreconcilable with an efficiency-based concept of antitrust injury, and it severely undercut the suggestion in *ARCO* that constrained dealers and consumers are perfectly viable plaintiffs.[191] As we shall see, *Khan* does not completely eliminate the strain that maximum vertical price fixing law places on the antitrust injury rule. And, to the extent that other substantive doctrines are inconsistent with the injury requirement, other sources of tension exist.[192] Nevertheless, the antitrust injury doctrine rests more comfortably today because of *Khan.*

C. The Rule of Reason

We come to the primary weakness of *Khan,* which concerns the rule the Court ostensibly adopted to replace *Albrecht.* The Court did not hold that maximum vertical price fixing is legal per se, but rather that it is to be judged under the rule of reason. Indeed, the Court noted, "[W]e *of course* do not hold that all vertical maximum price fixing is per se lawful. Instead, [the practice], like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason."[193] Well, why is the practice "of course" not legal per se? For that matter, just why are so few commercial arrangements per se legal? And how exactly can an instance of vertical maximum price fixing fail the test of reasonableness?

Perhaps we take the Court too literally. After all, the major advance in *Khan* was the repudiation of *Albrecht,* and, if maximum verti-

191 Of course, the Court could easily have resolved *ARCO* by repudiating *Albrecht* rather than by resorting to antitrust injury, and one wonders why the Court took different approaches in *ARCO* and *Khan.* Possibly the Court's attitude toward maximum vertical price fixing changed over the seven years after it decided *ARCO*; the composition of the Court certainly changed. In the interim, Justice Souter replaced Justice Brennan; Justice Thomas replaced Justice Marshall; Justice Ginsburg replaced Justice White; and Justice Breyer replaced Justice Blackmun. *See* WILLIAM COHEN & JONATHAN D. VARAT, CONSTITUTIONAL LAW 1718 (10th ed. 1997). Or possibly the Court wanted to refine the antitrust injury doctrine in 1990 and seized an opportunity to do so; by 1997, it may have been more interested in the substantive doctrine.

192 For example, minimum vertical price fixing remains illegal per se even when it increases consumer welfare. The substantive rule is in inescapable tension with the requirement that a private plaintiff demonstrate an injury related to an inefficient aspect of the practice.

193 *Khan,* 118 S. Ct. at 285 (emphasis added).

cal price fixing is proclaimed not to be illegal per se, what harm is done by admitting the possibility that the practice may be unreasonable? Surely the qualification conduced toward a unanimous decision, a nice attribute of an opinion. And if no future court in fact finds the practice unreasonable, unanimity may seem to be purchased at zero cost. Besides, maybe the Court did not really mean what it said. Maybe the practice really is never to be condemned, despite the Court's contrary assertion. But we take the Court at its word, and its word does have costs, though again the magnitude of those costs is uncertain.

One flaw in recognizing the possibility of unreasonableness is the tension that it creates in the logic of the opinion. The Court made quite clear that the anticompetitive effects attributed to vertical maximum price fixing in *Albrecht* and repeated in later cases do not withstand scrutiny. If those effects are illusory, the implication seems to be that the practice never has the kind of effects necessary to deem it unreasonable. True, one might argue that the Court has other possible anticompetitive effects in mind. But the Court offers no hint of any, and recall that Judge Posner was unable even to imagine any other effects.

Perhaps, though, we are too hasty in concluding that the Court intended to reject the theoretical possibility of the *Albrecht* effects. We think not. The concern that vertical maximum price fixing "could interfere with dealer freedom" is a tautology, not an anticompetitive effect.[194] The response to the claim that the manufacturer might set the price cap too low for the dealer to provide optimal services seems to be that the suggestion is implausible, not that it is impossible. Such a decision would injure the manufacturer, and firms are assumed to maximize profits.[195] But the response actually is more fundamental.

194 *Id.* at 282.

195 *See supra* note 90 and accompanying text. Though the record is not entirely clear, *Khan* probably is not a case where, for reasons of transaction costs, the supplier refused to allow the dealer to provide additional services and raise price to a profit-maximizing level in an unusual local market. The dealership contract allowed Khan to ask State Oil to raise the suggested resale price if he believed it to be too low, and State Oil would either agree or not agree to an increase. *See Khan*, 93 F.3d at 1360. The apparent inference is that the supplier contemplated treating at least Khan's market individually. Perhaps the contract provision was illusory, and State Oil did not in fact intend to negotiate separate suggested resale prices for its dealers, but we can assume that State Oil was willing to consider setting resale prices on the basis of individual locations. If that is so, alternative conclusions are possible. First, had State Oil refused to raise its suggested price (in fact, the receiver apparently never requested a price increase), its decision might have been a mistake. In that event, Khan could have earned additional profits by exceeding the price cap and providing additional

The market provides its own sanction for the manufacturer's mistake, and the antitrust laws should not and generally do not provide a remedy when the market is quickly self-correcting, for antitrust intervention is predictably more costly. Similarly, if vertical maximum price fixing channels distribution through "large or specially advantaged dealers" to the detriment of more efficient dealers, the market will sanction the manufacturer; if the disadvantaged dealers are equally or less efficient, consumers either suffer no harm or enjoy a benefit.[196] Having explained why these three concerns are not antitrust concerns at all, the Court's conclusion that they can be addressed under the rule of reason makes little sense.[197]

The one *Albrecht* effect that stands up in theory is that vertical maximum price fixing may be minimum price fixing in disguise. Vertical minimum price fixing may be anticompetitive, for it can facilitate supplier or dealer collusion, even if it is rarely used for this purpose. The Court seemed most troubled by this potential effect,[198] but concluded that it could be "recognized and punished under the rule of reason."[199] The problem of disguised resale price maintenance, however, is one of characterization, not one concerning the appropriate rule for vertical maximum price fixing. Thus, the Court could hold that vertical maximum price fixing is legal per se, but that, when it is really minimum price fixing, it is illegal per se as a device that facilitates a cartel.

The judicial imagination is bounded, however. Perhaps actual, vertical maximum price fixing can have anticompetitive effects in ways that the Court, the litigants, and Judge Posner apparently could not imagine.[200] And so, retaining the rule of reason to govern this prac-

services, but State Oil, too, would have lost profits. State Oil would have been penalized for its own mistake, and antitrust intervention would have been unnecessary. Alternatively, additional profits that Khan could have earned might have represented exploitation of his downstream monopoly power. Those profits would have come at the expense of State Oil and consumers, and preventing the price increase would have served the purposes of the antitrust laws.

196 *Khan*, 118 S. Ct. at 283.

197 *See id.* (noting that these "other concerns articulated in *Albrecht* can be appropriately recognized and punished under the rule of reason").

198 As to the other three concerns extracted from *Albrecht*, the Court repeated scholarly criticisms; as to this concern, however, the Court did not. *See id.* at 282–83.

199 *Id.* at 283.

200 As our economic analysis of the monopsony hypothesis demonstrates, a supplier could conceivably have monopsony power in the purchase of distribution services, and it could unilaterally exploit that power through vertical maximum price fixing. *See supra* notes 158–59 and accompanying text. In such circumstances, the practice is inefficient. We would argue that it should nevertheless be lawful because it

tice may allow it to be appropriately outlawed in some surprising, future setting. That possibility requires us to consider just how the rule of reason is to be applied. Courts now generally begin a full-blown inquiry into reasonableness by asking whether the defendant has market power.[201] If it does not, the case ends; if it does, the practice is subject to further review. As our economic analysis demonstrates, the market power screen is useless in the context of maximum vertical price fixing. The practice typically has no purpose unless the upstream firm has market power.

One can attempt to finesse this obstacle by interpreting the screen to require *substantial* market power or power in an *inter*brand market,[202] but the effort is misguided. First, the level of market power deemed critically significant is impossible to capture in a standard, and measuring market power according to some usable metric is usually impractical. For that matter, market power presupposes a properly defined market, and market definition is notoriously imprecise. More importantly, the amount of market power is irrelevant to the economic purpose and effects of the practice. The logic of the market power screen is that vertical maximum price fixing is more likely to be anticompetitive as the upstream firm's market power rises above some level. But the practice in fact is incapable of causing anticompetitive effects regardless of the amount of market power the firm has. Indeed, the efficiency-enhancing effect of the practice becomes more obvious the greater the firm's market power.

Focusing on interbrand market power is no more useful. In *Khan*, for instance, the Court reconfirmed its "general view that the primary purpose of the antitrust laws is to protect interbrand competition."[203] The distinction between interbrand and intrabrand competi-

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is the counterpart to the perfectly lawful exploitation of monopoly power. If the supplier has not otherwise violated the antitrust laws in acquiring its monopsony position, the implication is that the upstream firm provided an economic benefit to the downstream firms by creating a market for their services. By hypothesis, the upstream firm would have no monopsony power if the dealers had alternative employment. Like the monopolist, then, the monopsonist should be permitted to exploit its power in order to create an incentive to create the dealership opportunity.

201 The Court has implied that a plaintiff must show that the defendants had market power in a case subject to full-blown rule of reason analysis. *See* FTC v. Indiana Federation of Dentists, 476 U.S. 447, 460–61 (1986) (holding that a plaintiff need not prove the defendant's market power either when the challenged restraint of trade is naked or when the plaintiff proves an actual anticompetitive effect); *see also* Posner, *supra* note 23, at 16 (collecting cases).

202 For example, Posner describes the approach as requiring "substantial market power in a relevant market." Posner, *supra* note 23, at 16.

203 *Khan*, 118 S. Ct. at 282.

tion, first emphasized by the Court in *Sylvania*, has been interpreted to imply that a distributional restraint passes the test of reasonableness if it "stimulate[s] interbrand competition" more than it "reduces intrabrand competition."[204] In *Sylvania*, the distinction between interbrand and intrabrand competition made some sense, though we would have articulated the point differently. Recall that the manufacturer in that case imposed location restrictions on its dealers, thereby strengthening their territorial exclusivity in order to compete more vigorously with other manufacturers of television sets. If competition is viewed as a process for maximizing consumer welfare, then the territorial restraint did not restrict intrabrand "competition" at all. To be sure, it limited rivalry among dealers in the same brand of appliance, but it did so in a way that increased competition. A restraint either increases consumer welfare or it does not; opposite effects are not netted out. In essence, the term "competition" in the supposed balancing test is used in two different senses, so the test, despite its seductive simplicity, just cannot be applied.[205] Still, the Court properly was more concerned with promoting competition across brands of television sets than in preserving rivalry among Sylvania's dealers. In the classic successive monopoly case, however, there is neither interbrand nor intrabrand competition to promote or to protect.

Consider the situation in *Albrecht*. The Globe-Democrat was the only publisher of a morning newspaper in St. Louis. As a result, there was no real interbrand competition—there were no other brands. Albrecht had an exclusive distribution territory and, therefore, was insulated from competition in the home delivery of the newspaper. Thus, there was no intrabrand competition either. The purpose of a maximum resale price restraint is to take the place of competition. Because there are no other distributors to force the home delivered price to the competitive level, the publisher prevents the distributor from raising price above the competitive level. Thus, the purpose of this price restraint has nothing to do with promoting interbrand or intrabrand competition.

In *Khan*, the situation may have been a bit different, but the emphasis on interbrand competition is nonetheless misplaced. State Oil does not have a monopoly in gasoline. To the extent that consumers may have a preference for Union 76 brand gasoline, State Oil will

204 324 Liquor Corp. v. Duffy, 479 U.S. 335, 341–42 (1987).

205 *See* Posner, *supra* note 23, at 8, 18–22 ("[T]he idea of balancing the (assumed to be anticompetitive) effects of the restriction on intrabrand competition with the (assumed to be procompetitive) effects of the restriction on interbrand competition . . . is infeasible and unsound.").

enjoy some amount of market power. Given the presence of rivals selling somewhat differentiated products that are relatively good substitutes for Union 76 gasoline, State Oil's imposition of maximum resale prices will promote interbrand competition. Of course, State Oil's purpose is to earn more profit for itself, but in so doing State Oil competes with other brands. The economic benefits of maximum vertical price fixing do not depend on whether it stimulates interbrand competition.

Further, any utility that distinguishing interbrand from intrabrand competition might have was undercut by *Kodak*. There, the Court was willing to hold that replacement parts and repair service for Kodak equipment were relevant antitrust markets even though Kodak equipment competes with other brands. Of course, the Court did not hold that a brand always constitutes a relevant market, and the high levels of switching and information costs that prompted the Court to define the Kodak brand as a relevant market will not always be present. But the possibility will predictably induce litigants to claim that, in their cases, the individual brands do define markets. Given that information and switching costs are always positive and that the Court gave little guidance on how high these costs must be to justify defining a brand as a market, the claim that a brand is a market will rarely be frivolous.

The possibility that plaintiffs will routinely assert that the defendant's brand is a market and that the vertical maximum price restriction therefore is somehow anticompetitive illustrates a fundamental problem with subjecting maximum resale price fixing to the rule of reason. It is not costless. As we have shown, the distinction between interbrand and intrabrand competition is at best irrelevant, and the search for "substantial" market power is similarly misguided. The Court offers no other clue as to when an instance of maximum resale price fixing will fail the reasonableness test. Yet, so long as the practice can be condemned, there is an incentive to challenge it, especially by private parties who stand to recover treble damages. Conflict with the antitrust injury doctrine knocks at the back door: if the Court states clearly that maximum resale price fixing can violate the rule of reason, then is it not likely that the Court means to imply that some private plaintiffs suffer antitrust injury as a result of the practice? But where is the anticompetitive harm? Perhaps the federal government has not been an enthusiastic enforcer of *Albrecht*, but prosecutorial attitudes can change. Leaving open the possibility that vertical maximum price fixing violates the rule of reason is mischievous, for it encourages costly legal challenges of a practice that does not have anticompetitive effects.

There is an alternative to both per se illegality and the rule of reason, of course. It is per se legality, and given the lack of justification for applying any rule that condemns the practice, the alternative is appealing. Yet as the Court noted, "the majority of commercial arrangements subject to the antitrust laws" should be evaluated under the rule of reason.[206] Interestingly, the Court does not tell us whether *any* of the remaining practices in this universe of commercial arrangements are per se legal; they might all be per se illegal. Richard Posner has called the rule of per se legality "that most rarely used of antitrust techniques."[207] In fact, one is hard pressed to think of a single practice that the Court has declared to be per se legal, though per se legality is the implication of the Court's treatment of an arrangement or two. For instance, a purely unilateral action within the confines of the *Colgate* doctrine cannot violate the antitrust laws.[208] The mystery is why the Court is so reluctant to ascribe per se legality status to commercial arrangements. Just as an efficiency-enhancing instance of a per se illegal practice is sacrificed for the benefits of a per se rule, one could imagine tolerating an anticompetitive instance of a per se legal practice for the same reason.[209] This is not the place to explore in depth the Court's hostility toward the rule of per se legality. We note, however, that maximum vertical price fixing is the likeliest candidate we can imagine for per se legality treatment. The Court's insistence that the practice remain subject to the rule of reason indicates that the Court has no interest in declaring a commercial arrangement per se legal anytime soon.

D. *Impact on Other Antitrust Doctrines*

Antitrust futurists will enjoy predicting the effect *Khan* will have in areas beyond vertical maximum price fixing. We have already said that the decision bodes ill for per se lawful treatment of any practice. The most intriguing question, though, is whether the decision signals the repudiation of the per se rule against vertical *minimum* price fixing in favor of the rule of reason. Those who foresee the demise of *Dr. Miles* are not of one mind, of course. Some would applaud the change; others would decry it. Indeed, our suspicion is that many who

206 *Khan*, 118 S. Ct. at 285.

207 Posner, *supra* note 23, at 23.

208 *See* United States v. Colgate & Co., 250 U.S. 300 (1919) (holding that a supplier's unilateral actions to maintain resale prices cannot violate section 1 for lack of an agreement even though vertical price agreements are illegal per se).

209 *See, e.g.*, Posner, *supra* note 23, at 23 ("The same considerations of judicial economy and legal certainty that justify use of per se rules of illegality in some cases justify the use of rules of per se legality in others.").

supported retention of the *Albrecht* rule took that stance not because they feared the consequences of vertical maximum price fixing, but because they feared that repudiation of *Albrecht* would lead to repudiation of *Dr. Miles*.[210]

In our opinion, the downfall of *Dr. Miles* is nowhere in sight, though not because the per se rule against resale price maintenance is decidedly more defensible than the per se rule against vertical maximum price fixing. Rather, our surmise is based on four related reasons. First, the proposition that consumers can benefit when a supplier insists on higher retail prices continues to meet popular resistance.[211] Many are convinced that higher prices invariably make consumers worse off, even though the package of product and service is more desirable. Second, scholarly commentary is not nearly as consistent and overwhelming in opposition to *Dr. Miles* as it was in opposition to *Albrecht*. Recall that the *Khan* Court was admittedly influenced by the weight of scholarship critical of the per se rule against vertical maximum price fixing. Third, the legal inertia reflected in the doctrine of stare decisis was not as powerful in *Khan* as it would be if the Court were to reconsider *Dr. Miles*. The Court in *Khan* paid tribute to stare decisis, noting that it approached reconsideration of its decisions "with the utmost caution."[212] But few cases at any level of the judiciary had squarely presented the *Albrecht* rule, itself a relatively recent innovation, so the value in adhering to precedent was not great. By contrast, *Dr. Miles* has been around since 1911 and has been applied and reaffirmed in a score of cases. The Supreme Court itself has refused to repudiate the rule despite ready opportunities to do so.[213] Finally,

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210 For example, amici in *Khan* argued that "[o]verruling *Albrecht* will ripple far beyond maximum vertical price fixing. It will call into question almost a century of this Court's condemnation of all forms of price fixing . . . ." Brief of Thirty-Three States and the Territory of Guam in Support of Respondents at 9, State Oil Co. v. Khan, 118 S. Ct. 275 (1997) (No. 96-871). Our impression is that the form of price fixing about which these amici were most concerned was resale price maintenance.

211 *See, e.g., Baer Briefs New York Bar Group on Recent Enforcement Developments*, 73 ANTITRUST & TRADE REG. REP., Dec. 4, 1997, at 528–29 (reporting comments of the FTC's Bureau of Competition Director to the effect that a per se rule against minimum resale price maintenance, unlike one against maximum vertical price fixing, is not "contrary to the purpose of bringing lower prices to consumers").

212 *Khan*, 118 S. Ct. at 284. Justice Breyer in particular has emphasized the importance of stare decisis to the rule of law. *See* Lopatka, *supra* note 60, at 18–19.

213 *See* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988) (avoiding reconsideration of the *Dr. Miles* rule in a case involving alleged termination of a dealer for price cutting); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761–62 n.7 (1984) (declining the "opportunity to reconsider" whether resale price maintenance agreements should be illegal per se); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 51 n.18 (1977) (distinguishing vertical price restraints from

the Court would provoke a political maelstrom were it to repeal *Dr. Miles*, whereas political interest in preserving *Albrecht* was not nearly as acute. A major feature of bills introduced to repeal *Monsanto* was the codification of the per se rule against minimum vertical price fixing, whereas they specifically exempted from the reach of the per se rule agreements on maximum resale prices.[214]

The *Dr. Miles* rule is not the only antitrust doctrine that could be affected by *Khan*. The treatment of any vertical restraint now subject to the rule of per se illegality might be reconsidered, and the other likely suspect is tying arrangements.[215] But even though tying is nominally subject to the per se rule, the rule as applied is tantamount to reasonableness review.[216] The Court is not likely to change the form of tying analysis in the near future,[217] and the substance of the analysis would not change much if it did. *Khan* might also affect the antitrust approach to certain horizontal arrangements. For example, we have already argued that an agreement between competitors to impose maximum resale prices, the kind of agreement thought to exist in *Kiefer-Stewart*, should not be illegal per se but rather subject to the rule of reason, though we are not optimistic that the Court will agree.[218] Another possibility is that the Court will reconsider per se treatment

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vertical non-price restraints for purposes of repudiating the per se rule against only the latter).

214 *See, e.g.*, The Consumer Protection Against Price-Fixing Act of 1991, S. 429, 102nd Cong. § 3 (version 3, May 12, 1991) ("[T]he fact that the seller of a good or service and the purchaser of a good or service entered into an agreement to set, change, or maintain the resale price of a good or service shall be sufficient to constitute a violation . . . , except that this section shall not apply when the agreement [pertains to] the maximum resale price of a good or service. Such maximum resale price agreements shall not be deemed illegal per se; such agreements shall be judged on the basis of their reasonableness."); Price Fixing Prevention Act of 1991, H.R. 1470, 102nd Cong. § 2 (version 2, Oct. 4, 1991) ("[T]he fact that the seller of a good or service and the purchaser of such good or service entered into an agreement to set, change, or maintain the price (other than a maximum price) of such good or service for resale shall be sufficient to constitute a violation . . . .").

215 A tying arrangement "may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." Northern Pacific Ry. v. United States, 356 U.S. 1, 5–6 (1958).

216 *See generally* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984); Lopatka, *supra* note 60, at 68–69 (observing that "the per se rule in tying cases mimics a rule of reason").

217 In *Jefferson Parish*, a majority of the Court observed that "[i]t is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable 'per se.'" *Jefferson Parish*, 466 U.S. at 9.

218 *See supra* notes 177–83 and accompanying text.

of horizontal agreements to fix maximum prices, as opposed to resale prices.[219] That rule might change, but the change would have less to do with *Khan* than with reconsideration of the teaching of *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*[220] in the maximum price fixing context.

If *Khan* has an effect on other antitrust doctrines, we believe that its influence will be much more subtle than the possible effects just described. In fact, if these subtle changes occur, they will probably not be driven by *Khan* at all, but rather they and *Khan* will be driven by the same underlying impulse. That impulse might be characterized as skepticism toward assertions of anticompetitive impact and openness to explanations of the efficiency-enhancing capacity of restrictions, at least in the area of distributional restraints other than resale price maintenance. The Court, then, may assess various distributional restraints under the rule of reason more sympathetically in the future. We could imagine, for example, a more hospitable reaction to exclusive dealing arrangements and requirements contracts.[221]

This, however, is rank speculation on our part. Our best judgment is that the *Khan* Court meant to do exactly what it said it was doing, no more and no less. Those who would claim that *Khan* portends dramatic changes in antitrust dogma do so with little support.

VI. Conclusion

Khan significantly improved the state of antitrust law in two principal ways. First, it repudiated the rule that vertical maximum price fixing is illegal per se. That rule was ill-conceived. It was inconsistent with the purpose of antitrust law, and it prompted firms to adopt costly substitute practices to achieve the function of maximum resale price arrangements without violating the law. Second, *Khan* lessened

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219 *See* Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332 (1982) (holding an arrangement among physicians and insurers to set maximum prices for medical services illegal per se); *see also* Easterbrook, supra note 144 (arguing that the time has come to abandon any per se rule against maximum price fixing).

220 441 U.S. 1 (1979) (holding that the efficiencies incident to blanket copyright licensing meant that the arrangement was not illegal per se).

221 Exclusive dealing arrangements are agreements under which a dealer agrees to distribute the supplier's products and not those of the supplier's competitors. They are judged more or less harshly under the rule of reason. *See* Standard Oil Co. of Ca. v. United States (Standard Stations), 337 U.S. 293, 305–06 (1949). Requirements contracts, which are economically equivalent, provide that the purchaser will buy its entire requirements of a product from the supplier and are also subject to the rule of reason. *See* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961)

the strain on the antitrust injury doctrine. The per se rule against vertical maximum price fixing was fundamentally irreconcilable with the antitrust injury requirement, and so the rule threatened to undermine the economic core of an important procedural doctrine.

Although *Khan* contributed significantly to sound antitrust policy, the decision is flawed. It replaced the rule of per se illegality, not with a rule of per se legality, but with the rule of reason. In the context of maximum vertical price fixing, a test of reasonableness makes little sense. The practice has no discernable anticompetitive consequences in any setting. Further, the content of the test is a mystery, and therefore its application is unpredictable. Yet, admitting the possibility that the practice will be deemed unreasonable encourages costly challenges and perpetuates a degree of conflict with the antitrust injury doctrine.

In the end, the Court did well. It could have done better.