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The Case for Presuming the Legality of Quality Motivated Restrictions on Distribution

Thomas A. Piraino, Jr.*

“It is the unlawful combination, tested by the rules of common law and human experience, that is aimed at by this bill, and not the lawful and useful combination.”¹

I. The Philosophical Inconsistency of Vertical Restraint Analysis

Senator Sherman’s comments during the 1890 Congressional debates on the adoption of a national antitrust policy illustrate a dilemma that has continued to preoccupy antitrust practitioners in the 1980’s: how to distinguish commercial restrictions that should be tolerated because of their potential benefits from those which should be prohibited because of their anticompetitive effect.

This dilemma is evident today in the manner in which the courts distinguish price and nonprice vertical restraints. Since the *Sylvania*² case in 1977, the courts have recognized the competitive benefits of non-price vertical restrictions under the rule of reason.³ Price-related vertical restraints, however, continue to be subject to the per se rule.⁴

This divergent approach reflects the courts’ unwillingness to choose consistently between the two opposing antitrust philosophies embodied by the “Efficiency” and “Interventionist” Models. The Efficiency Model posits that price related resale restrictions can have the same positive effects on interbrand competition as nonprice restraints and thus should be afforded the same rule of reason treatment.⁵ Proponents of the Efficiency Model believe that manufacturers act in rational, market-driven ways to achieve the most efficient means of distribution.⁶ This model

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The opinions expressed by the author in this article do not necessarily reflect the opinions of Parker-Hannifin Corporation.

1 21 Cong. Rec. 2460 (1890).

2 *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (hereinafter “*Sylvania*”).

3 In contrast to a rule of per se illegality, the rule of reason requires courts to engage in an economic analysis of the reasonableness of a particular restraint before passing on its legality. The relevant factors to be considered in the rule of reason analysis were first set forth by the Supreme Court in *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918), and were cited by the Court in *Sylvania*, 433 U.S. at 49-50 n. 15.

4 The Court retained the per se rule for resale price-fixing in *Sylvania*, 433 U.S. at 51 n.18, and subsequently reaffirmed the rule explicitly in *California Retail Liquor Dealers Assoc. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) and *324 Liquor Corp. v. Duffy*, 107 S. Ct. 720 (1987) and implicitly in *Rice v. Norman Williams Co.*, 458 U.S. 654 (1982) and *Arizona v. Maricopa County Medical Society*, 445 U.S. 97 (1982).

5 See *infra* notes 42 to 46 and accompanying text.

6 The Efficiency Model derives from the conclusions of the so-called “Chicago School” that economic efficiency should be the only concern of the antitrust laws. See Bork, *The Antitrust Paradox: A Policy at War with Itself* 50-71 (1978); Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 13 (1977). This view initially became dominant among

assumes that manufacturers desire a high volume, low cost distribution system which coincides with consumers' desires for the lowest possible quality-adjusted price.⁷ The Efficiency Model concludes that, in the absence of a cartel, markets will automatically correct any inefficient vertical restraints that harm consumers.⁸ Since consumer welfare should be the exclusive goal of the antitrust laws,⁹ the courts generally should not intervene to prohibit any vertical restrictions, whether price or nonprice, which are instituted by the manufacturer to increase the efficiency of his distribution system.¹⁰

The Interventionist Model is based on the belief that the antitrust laws are intended not only to protect consumer welfare, but also to promote other social goals such as pluralism and economic independence.¹¹ Under this Model, vertical restrictions are viewed suspiciously because they inhibit the freedom of independent resellers to engage in intrabrand competition.¹² Thus, courts must take an active role in protecting the

influential members of the academic community, including Lester Telser, Ron Coase, Robert R. Bork, Yale Brozen, Richard A. Posner and Frank Easterbrook (Bork, *An Economist Appraises Vertical Restraints*, 30 ANTITRUST BULL. 117, 120-21 (1985)), and recently has been cited with increasing frequency by the courts as certain of its adherents have been appointed to the federal bench. See, e.g., *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 228 (D.C. Cir. 1986) (Bork, J.); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982) (Posner, J.). The Antitrust Division under the Reagan Administration has promoted the Efficiency Model as its advocates have been appointed to policy making positions at the Department of Justice. See Brett, *Monosanto: Expectations Unfulfilled*, 30 ANTITRUST BULL. 39, 50-51 (1985). One commentator has concluded that the Efficiency Model "has come to dominate antitrust policy in the past decade." Hovenkamp, *Distributive Justice and the Antitrust Laws*, 51 GEO. WASH. L. REV. 1, 1 (1982).

7 See Bork, *supra* note 6, at 97; Hovenkamp, *supra* note 6, at 5; Areeda and Turner, *Antitrust Law* 111-113 (1978); Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics*, 72 GEO. L. J. 1511, 1547-49 (1984); Bork, *A Reply to Professors Gould and Yarey*, 76 YALE L. J. 731, 742-43 (1967).

8 See, e.g., *Panel Discussion on Department of Justice Vertical Restraint Guidelines*, 54 ANTITRUST L. J. 319, 339 (1985) (comments of Rule).

9 Bork, *The Role of the Courts in Applying Economics*, 54 ANTITRUST L. J. 21, 24 (1985). The Supreme Court referred to consumer welfare as an antitrust goal in *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979), and proponents of the Efficiency Model on the federal bench have been quick to cite *Reiter* as indicative of the proper philosophical approach. See *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982) (Posner, J.); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 228 (D.C. Cir. 1986) (Posner, J.).

10 See Bork, *supra* note 6, at 55-56; R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE, 19-22 (1976).

11 See, e.g., Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1140 (1981); Schwartz, *'Justice' and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076, 1076 (1979). This view is supported by the legislative history of the Sherman Act, which indicates that Congress, concerned about the abusive power of trusts and monopolies, intended the antitrust laws to protect small business and to disperse economic and political power. 21 Cong. Rec. 3147 (1890). See Bohling, *A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis and Sylvania*, 64 IOWA L. REV. 461, 472 (1979); Hovenkamp, *supra* note 6, at 16-17. Continued support for such populist antitrust goals is evident in Congress' recent condemnation of the Justice Department's Vertical Restraints Guidelines (Pub. L. No. 99-180, 48 ANTITRUST & TRADE REG. REP. (BNA) 1199 (Supp. 1985) (hereinafter cited as the "Vertical Restraint Guides")), which advocate an efficiency approach to vertical restraints, and in Congress' prohibition, in annual appropriations bills, against the Department engaging in litigation to overturn the per se rule against resale price-fixing. 45 ANTITRUST & TRADE REG. REP. (BNA) 723-24 (Nov. 3, 1983). See *infra* note 59, for a discussion of Congressional support for such a per se rule.

12 In the 1950's and 1960's the Supreme Court was intent on protecting the economic freedom of small businessmen as it struck down various vertical restrictions on intrabrand competition. See, e.g., *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951); *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (maximum resale price maintenance); *Simpson v. Union Oil Co.*, 377 U.S.

economic rights of resellers against such restrictions. The Interventionist Model reached its apex in the 1967 *United States v. Arnold, Schwinn & Co.* decision,¹³ which held that territorial and customer restrictions should be per se illegal because they constituted an undue restraint on resellers' rights to sell "where and to whomever they choose."¹⁴

The U.S. Supreme Court in *Continental T.V., Inc. v. GTE Sylvania, Inc.* adopted the reasoning of the Efficiency Model by discarding the *Schwinn* per se rule and recognizing the efficiency justifications of nonprice restraints.¹⁵ However, the Court failed to recognize that such justifications may also apply to price related vertical restraints. The Court's continuation of the per se rule for resale price maintenance¹⁶ helped to perpetuate the Interventionist Model¹⁷ and guaranteed continuing conflict over which Model courts should use to analyze price-related vertical restraints. Indeed, one observer has concluded that "the proper treatment of vertical price-fixing is the principal unresolved antitrust question of the day."¹⁸

Sylvania and other recent decisions have failed to articulate a consistent economic rationale for the dichotomy between price and nonprice vertical restraints. Continued use of the per se rule for resale price maintenance may be based on a reluctance to overrule prior precedent, deference to Congressional intent to retain the per se rule, or the simple misbelief that markets actually work in the manner assumed by the Efficiency Model.¹⁹

Without a substantive economic basis for the rule against resale price maintenance, the courts have resorted to analyzing price related restraints simply by their form. This has resulted in a confusing set of rules under which the legality of such restraints turns on a fine legal distinction between unilateral and concerted conduct.²⁰ This distinction is

12 (1964) (minimum resale prices imposed upon consignee); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled by Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (territorial and customer restrictions).

13 *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled by Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

14 *Id.* at 378.

15 In one part of its opinion, the Court appeared to expressly choose the rationale of the Efficiency Model over that of the Interventionist Model: "Competitive economics have social and political as well as economic advantages . . . but an antitrust policy divorced from market considerations would lack any objective benchmarks." 433 U.S. at 53 n.21.

16 433 U.S. at 51 n.18.

17 Many commentators continue to argue that the Efficiency Model is too static and narrow and that there should be room in antitrust law for the consideration of political and social factors other than economic efficiency. See, e.g., Markovits, *The Limits to Simplifying Antitrust: A Reply to Professor Easterbrook*, 63 *TEX. L. REV.* 4, 74 (1984); Rowe, *Antitrust in Transition: A Policy In Search of Itself*, 54 *ANTITRUST L. J.* 5, 12-13 (1985); Sullivan, *On Non-price Competition: An Economic and Marketing Analysis*, 45 *U. PITT. L. REV.* 771 (1984); Spivach, *The Chicago School Approach to Single Firm Exercises of Monopoly Power: A Response*, 52 *ANTITRUST L. J.* 651, 653 (1983). The Supreme Court even referred recently in dicta to the necessity to preserve "freedom of traders" (*Assoc. General Contractors of Cal. Inc. v. State Council of Carpenters*, 459 U.S. 519, 529 n.18 (1983)), a cherished goal of the Interventionist Model. Congress continues to adhere to the Interventionist Model in its support of the per se illegality of resale price maintenance. See *infra* note 59.

18 Supplemental Brief for Cross-Petitioner in Petition for Writ of Certiorari in *Business Electronics Corp. v. Sharp Electronics Corp.*, No. 85-2094, at p. 9.

19 See *infra* notes 53 to 60 and accompanying text.

20 See *infra* notes 61 to 72 and accompanying text.

difficult for businessmen and practitioners to understand and for courts to apply. Because of the uncertainty generated by this formalistic approach, many manufacturers have been discouraged from adopting procompetitive vertical restrictions.

The Supreme Court recently granted certiorari in a case, *Business Electronics Corporation v. Sharp Electronics Corporation*,²¹ which may allow the Court to reduce the uncertainty of the current approach to resale price maintenance. In *Sharp* the Court will consider, for the first time since 1984, the type of agreement between a manufacturer and his distributors which constitutes price-fixing in violation of the Sherman Act.

This article suggests a method of analyzing the substantive competitive effect of vertical restrictions that avoids the "chilling effects" of the current approach and reconciles the divergent philosophies of the Efficiency and Interventionist Models. The suggested approach views the manufacturer's motive, rather than the form of the vertical restraint, as determinative. In specific cases in which the courts can be reasonably certain of a manufacturer's procompetitive motives, all vertical restrictions, whether price or nonprice, should be afforded a presumption of legality.

This article will demonstrate that certain quality motivated vertical restrictions should qualify for such a presumption. This approach will reduce the uncertainties and inconsistencies of the current formalistic analysis and free manufacturers to implement vertical restrictions that enhance their competitiveness and reduce the quality adjusted price of their products to consumers.

II. The Efficiency Arguments for Nonprice Vertical Restraints

In *Sylvania*, the Court abandoned *Schwinn's* formalistic view that restrictions on resale were inherently evil²² and instead looked to the substantive competitive effect of nonprice vertical restrictions to determine their legality. The Court identified several possible "efficiencies" of the location clause at issue that might increase interbrand competition, including inducing retailers to engage in promotional and service activities and controlling the safety and quality of products.²³ Given the possible efficiencies of vertical restrictions, the Court concluded that it was more appropriate to weigh their competitive advantages against the slight potential decline in intrabrand competition than to apply the *Schwinn* per se rule.²⁴

Other courts and commentators following the Efficiency Model have elaborated on a manufacturer's procompetitive rationale for restricting competition among his distributors through vertical restraints. A manufacturer does not act irrationally and impose vertical restrictions on dealers to suppress or injure them but to make his products more attractive

21 107 S.Ct. 55, cert. granted (June 8, 1987).

22 388 U.S. at 379.

23 433 U.S. at 55.

24 *Id.* at 57-59.

to consumers.²⁵ Indeed, in imposing vertical restrictions, a manufacturer is only achieving by contract "what a vertically integrated firm would achieve through internal command."²⁶ Such contractual restrictions have less anticompetitive impact than vertical integration and should not, therefore, be treated more harshly.²⁷

Customer or territorial restrictions on resales by distributors diminish intrabrand price competition, and as a result, increase resale prices. The increased prices resulting from vertical restraints conflict with manufacturers' general preference for a high volume, low markup distribution policy. Manufacturers will usually want to retain as much intrabrand competition as possible within their distribution systems, because such competition encourages low resale costs.²⁸ A manufacturer will only use vertical restraints that limit such competition if they provide a corresponding benefit that increases demand for his product. Such a benefit is derived from increased point-of-sale services that are desirable to consumers, such as presale product explanations and postsale repairs and service. Territorial and customer restrictions help insure that distributors will have a sufficient resale margin to afford such services.

The Efficiency Model recognizes that consumer demand for a product consists of the demand for such associated point-of-sale services as well as demand for the product itself.²⁹ In order to avoid unnecessary resale price increases, a manufacturer will attempt to limit vertical restrictions to the minimum level necessary to encourage the exact amount of services desired by his customers. If the point-of-sale services have a value to consumers greater than the amount of any price increases caused by the restrictions, the quality adjusted price of the manufacturer's product will actually decline, and he will gain market share from competing producers. Vertical restrictions that encourage services with such a value to consumers are output enhancing, and by definition, procompetitive.³⁰

²⁵ Panel Discussion, *Counseling Your Client on Horizontal and Vertical Restraints*, 55 ANTITRUST L. J. 293, 304 (1986), (comments of Weinbaum).

²⁶ Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way Out?*, 67 VA. L. REV. 1457, 1490 (1981).

²⁷ See, e.g., *Red Diamond Supply Inc., v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1006-1007 (5th Cir. 1981); Phillips & Mahoney, *Unreasonable Rules and Rules of Reason: Economic Aspects of Vertical Price-Fixing*, 30 ANTITRUST BULL. 99, 102 (1985). Among the disadvantages of the *Schwinn* per se rule cited in *Sylvania* was the "incentive for vertical integration" created by the harshness of the rule. 433 U.S. at 57 n. 26. Vertical integration of newspaper publishing and distribution was, in fact, the consequence of the Court's application of the per se rule to maximum resale price maintenance in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). Marks & Jacobson, *Price-Fixing: An Overview*, 30 ANTITRUST BULL. 199, 254 (1985).

²⁸ The Court in *Sylvania* cited the arguments of Bork and Posner when it referred to this Efficiency Model position. 433 U.S. at 56. See also Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283 (1975); White, *Vertical Restraints in Antitrust Law: A Coherent Model*, 26 ANTITRUST BULL. 327, 330 (1981).

²⁹ Popofsky & Bomse, *From Sylvania to Monsanto: No Longer a 'Free Ride'*, 30 ANTITRUST BULL. 67, 88 (1985). "Price" is thus defined in economic terms as "a shorthand for a value that includes a product and associated service". See Bock, *supra* note 6, at 123.

³⁰ Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 32 (1984); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 21 (1981). The Antitrust Division under the Reagan Administration has taken the position that vertical restrictions are

The Efficiency Model assumes that consumer welfare should be the exclusive goal of the antitrust laws.³¹ Manufacturers should therefore be allowed to restrict resellers who threaten the viability of distribution systems designed to promote customer services. Thus was born the concept of the "free-rider", a distributor who, in lieu of hiring sufficient personnel to explain or service products for consumers, merely "free-rides" on such services provided by other distributors.³² Free-riders can engage in severe price-cutting because of their low overhead. The prospect of losing sales to such free-riders discourages distributors from providing services desired by consumers. Vertical restrictions have often been justified by the need to insure the continuation of point-of-sale services by protecting full service resellers against such free-riders.³³

III. The Economic Equivalency of Price and Nonprice Restraints

The procompetitive justifications for nonprice vertical restrictions apply with equal force to price related vertical restrictions. Like territorial or customer restrictions, minimum resale price maintenance can be used by a manufacturer to encourage customer services.³⁴ Resale price maintenance is a more precise method of guaranteeing distributors a sufficient margin for point-of-sale services.³⁵ The practice is less restrictive of intrabrand competition than exclusive territorial clauses because it al-

generally procompetitive; the Vertical Restraint Guides are an attempt to summarize this view and convince the courts to adopt a similar position. See Kleine, *New Department of Justice Vertical Restraints Guidelines - A Search for Legal Certainty*, 40 BUSINESS LAW. 1335, 1336 (1985); Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L. J. 687, 710 (1983); *Panel Discussion*, *supra* note 8 at 326-27 (comments of Slater). The Vertical Restraint Guides have been cited by a few courts (see *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 672 (7th Cir. 1985); *Miller Instituform, Inc. v. Instituform of N.A. Inc.*, 605 F.Supp. 1125, 1132 n.6 (M.D. Tenn. 1985)), but have been repudiated by Congress. See *supra* note 11.

31 See *supra* notes 6 to 10 and accompanying text.

32 The "free-rider" argument was first made by Professor Lester Telser in a 1960 article. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J. LAW & ECON. 86 (1960). The article has been cited frequently by followers of the Efficiency Model. See, e.g., Popofsky and Bomse, *supra* note 29, at 87; Posner, *supra* note 28, at 285.

33 *Sylvania* cited the free-rider argument. 433 U.S. at 55. The argument has been referred to by courts in subsequent decisions upholding nonprice vertical restrictions. See, e.g., *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F.Supp. 750, 758-59 (D. Md. 1980), *aff'd per curiam*, 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981).

34 This discussion concerns only minimum resale price maintenance. Maximum resale price-fixing has the opposite effect of minimum resale price maintenance. Instead of encouraging non-price competition at the expense of price competition, maximum resale price-fixing encourages price competition at the expense of competition in customer services. Bohling, *supra* note 11, at 520-21. Maximum price-fixing is even more intuitively procompetitive than minimum price-fixing, for it drives "prices toward the level that would be set by intense competition". *Albrecht v. Herald Co.*, 390 U.S. 145, 159 (1968) (Harlan, J., dissenting). Nevertheless, the majority in *Albrecht* applied the per se rule to maximum resale price fixing. *Albrecht*, however, relied in part upon *Schwinn's* prohibition of exclusive territories. *Id.* at 153-154. Some courts and commentators have pointed out that, in overruling *Schwinn*, *Sylvania* "demolished" the logic of *Albrecht*. See, e.g., Posner, *supra* note 30, at 12. See also *Jack Walters & Son v. Morton Bldg.*, 737 F.2d 698, 706-07 (7th Cir. 1984) (Posner, J.); Marks & Jacobson, *supra* note 27, at 255. Since exclusive territories are now acceptable under *Sylvania*, it is more reasonable to allow manufacturers to control maximum resale prices to insure that distributors do not exact monopoly profits within their exclusive territories. Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restriction*, 78 COLUM. L. REV. 1, 16 n. 59 (1978).

35 Posner, *supra* note 28, at 294; See also Baker, *supra* note 26, at 1465 n. 37.

lows distributors to continue to compete in the nonprice arena.³⁶ In fact, by limiting price competition the manufacturer can actually encourage greater competition among his distributors in the provision of customer services.³⁷ Resale price maintenance therefore does more than protect distributors' resale margins against price-cutting free-riders. By allowing intrabrand nonprice competition to continue, it also encourages distributors to use their guaranteed margin to provide better services and not simply to increase their profit.

In *Sylvania* the Court recognized that a manufacturer will not use vertical restrictions that reduce the net demand for his products.³⁸ As with nonprice restraints, a manufacturer will only want to use resale price maintenance if it enhances his interbrand competitiveness. Resellers' providing of point-of-sale services to customers will benefit the manufacturer "as long as the positive effect on demand outweighs the depressing effect of the accompanying rise in price."³⁹ Therefore, in a competitive market, a manufacturer will only set resale prices at the minimum level necessary to encourage the amount of services desired by his customers. Any higher resale prices will ultimately harm the manufacturer and, absent a cartel at the dealer or manufacturer level,⁴⁰ the manufacturer should be no more willing to injure himself with price related vertical restraints than with nonprice restraints.⁴¹

The Efficiency Model, therefore, finds no logical distinction between the economic justifications of price and nonprice restraints. Both types of restraints protect dealers against price competition and thus can be used as a method of encouraging dealer services.⁴² The same redeeming benefits to interbrand competition that *Sylvania* recognized for nonprice restrictions apply to price related restraints.⁴³ The free-rider arguments in favor of territorial clauses "are equally available to justify resale price

36 "The territorial restriction affects both price and service competition; the price restriction affects only price competition." Posner, *supra* note 30, at 9. See also *Panel Discussion, Antitrust Do's and Don'ts of Distribution*, 53 ANTITRUST L. J. 363, 378 (1984) (comments of Reasonser); Bohling, *supra* note 11, at 501. In *Eastern Scientific Co., v. Wild Herrburgg Instruments*, 572 F.2d 883 (1st Cir.), *cert. denied*, 439 U.S. 833 (1978), the First Circuit held that a manufacturer could preclude a dealer from selling at less than a fixed price outside his territory because the impact on competition was less than if the manufacturer had required an airtight territorial restriction. See also *Hochstadt v. Worcester Foundation*, 545 F.2d 222 (1st Cir. 1976) (requirement that dealer charge list price or higher on sales outside assigned territory should be judged by rule of reason). *But see* Pitofsky, *supra* note 34, at 17 (arguing that even under airtight territorial clauses, manufacturer has incentive to respond to pressure from dealers to cut resale prices because of competition from dealers of other brands).

37 "The reduction in dealers' rivalry in the price dimension is just the tool the manufacturer uses to induce greater competition in the service dimension." Easterbook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L. J. 135, 156 (1984).

38 433 U.S. at 56 n.24.

39 Comanor, *Vertical Price-Fixing, Vertical Market Restrictions and the New Antitrust Policy*, 98 HARV. L. REV. 983, 987 (1985).

40 See *infra* notes 89-106 and accompanying text, for a discussion of the cartel argument against resale price maintenance.

41 Popofsky, *The Economics of Vertical Restraints: A Lawyer's Response*, 52 ANTITRUST L.J. 719, 722 (1983).

42 See Posner, *supra* note 6, at 4; Easterbrook, *supra* note 37, at 156.

43 Posner, *supra* note 6, at 8. In fact, Justice White's concurring opinion in *Sylvania* explicitly recognized that "the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well." 433 U.S. at 69.

maintenance."⁴⁴ Since vertical price and nonprice restraints are "functionally equivalent,"⁴⁵ continuation of the per se rule for resale price maintenance denies manufacturers the full benefit of *Sylvania's* understanding of the economic benefits of vertical restraints.⁴⁶

In *Monsanto Co. v. Spray-Rite Service Corp.*,⁴⁷ the Supreme Court recognized that price and nonprice restrictions have the same economic effect. The case arose out of Monsanto's termination of a distributor following complaints from other distributors about the distributor's price-cutting. The Court stated that Monsanto had a legitimate interest in maintaining territorial and customer restrictions that encouraged customer services.⁴⁸ Monsanto's proper interest in preserving such nonprice restraints, the Court conceded, could not be readily separated from the company's interest in distributors' resale prices.⁴⁹ A manufacturer such as Monsanto with a legitimate system of nonprice vertical restraints is likely to discuss resale prices with distributors because the manufacturer wants to insure that distributors maintain an adequate margin to pay for customer services and "that 'free-riders' do not interfere."⁵⁰ Such concerns are legitimate under *Sylvania's* efficiency rationale. Therefore, the Court concluded that Monsanto's mere receipt of complaints about the terminated distributor's price-cutting should not support the inference of a price-fixing conspiracy.⁵¹ The Court acknowledged the difficulty of distinguishing price from nonprice restraints in such circumstances and even expressly conceded that the economic impact of such restraints was identical.⁵²

IV. Formalistic Analysis of Resale Price Restraints

Despite its understanding of the identical economic impact of price and nonprice restraints, the Court in *Monsanto* declined to overrule the per se rule for resale price maintenance.⁵³ The price/nonprice dichotomy has been reaffirmed by the Court on other occasions since the *Sylva-*

44 Posner, *supra* note 6, at 9.

45 Popofsky & Bomse, *supra* note 29, at 89 n.68.

46 Liebel, *1983 Economic Review of Antitrust Developments: The Distinction Between Price and Nonprice Distribution Restrictions*, 31 UCLA L. REV. 384, 391 (1983).

47 465 U.S. 752 (1984).

48 *Id.* at 762-63.

49 *Id.* at 762.

50 *Id.* at 762-63.

51 *Id.* at 764.

52 "While these distinctions in theory are reasonably clear, often they are difficult to apply in practice. In *Sylvania* we emphasized that the legality of arguably anticompetitive conduct should be judged primarily by its 'market impact' But the economic effect of all of the conduct described above - unilateral and concerted vertical price setting, agreements on price and nonprice restrictions - is in many, but not all, cases similar or identical And judged from a distance, the conduct of the parties in the various situations can be indistinguishable." *Id.* at 762.

53 The Court stated that it had "no occasion to consider the merits" of overruling the per se approach because the issue had not been addressed by the lower courts. 465 U.S. at 762 n.7. The Court thus did not expressly reaffirm the per se rule. Only Justice Brennan, in a concurring opinion, said that there was "no reason for us to depart from our longstanding interpretation of the Act." 465 U.S. at 769. As a result, one opponent of the per se rule has concluded that the Court has "invited further challenges" to the rule. Easterbrook, *supra* note 37, at 171. However, the Court subsequently reaffirmed the rule in *324 Liquor Corp. v. Duffy*, 107 S. Ct. 720, 724-25 (1987).

nia decision.⁵⁴ In no case, however, has the Court articulated a clear economic rationale for this position.⁵⁵ In *Sylvania* the Court cited precedent, congressional intent and the cartel enhancing potentials of resale price maintenance as possible reasons for the rule, but it did not indicate a preference for any particular justification.⁵⁶ In *Keifer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*,⁵⁷ the Court emphasized that fixed resale prices "cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment."⁵⁸ On several occasions Congress has indicated that it shares this populist approach to the resale price-fixing issue.⁵⁹ Thus, "a nonefficiency reason — society's extrasensitivity to restrictions imposed on sellers' discretion to determine the price at which they choose to dispose of their property," rather than an economic rationale, may be the real basis for the continuing distinction between price and nonprice restraints.⁶⁰

54 The per se rule for resale price maintenance was reaffirmed in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) and *324 Liquor Corp. v. Duffy*, 107 S. Ct. 720 (1987).

55 Brief for the United States as *Amicus Curiae* in Support of Petitioner at 21, *Monsanto Co. v. Spray-Rite Service Corp.*, *supra* note 47.

56 433 U.S. at 51 n.18.

57 340 U.S. 211 (1951).

58 *Id.* at 213.

59 Congressional actions since the mid-1970's have demonstrated consistent support for the per se rule against resale price maintenance. In 1975, Congress repealed the so-called "fair trade" exemption for certain State-authorized resale price maintenance agreements. Pub. L. No. 94-145, § 3, 89 Stat. 801 (1975). When Congress repealed the fair trade laws, it "fully understood that it was adopting the per se rule prohibiting vertical price-fixing." Seiberling, *Congress Makes Laws: The Executive Should Enforce Them*, 53 ANTITRUST L. J. 175, 177 (1984). Congress has continually been at odds with the Antitrust Division under the Reagan Administration, which has failed to bring any resale price maintenance cases. 52 ANTITRUST & TRADE REG. REP. (BNA) 269 (February 12, 1987). Moreover, the Division filed an *Amicus Curiae* Brief in *Monsanto* arguing that the per se rule against vertical price-fixing should be overruled. 465 U.S. 752, 753-54 (1984). Immediately before oral argument, Congress forbade, in the Justice Department appropriations Bill, any argument against the per se rule by the government in open court. Pub. L. No. 98-166, § 510, 97 Stat. 1071, 1102 (1983). See also Steuer, *Monsanto and the Mothball Fleet of Antitrust*, 30 ANTITRUST BULL. 1, 8 (1985). In fact, appropriations bills for the Department of Justice for the past five years have prohibited the use of funds for overturning or altering the per se rule against resale price maintenance. 52 ANTITRUST & TRADE REG. REP. (BNA) 1127 (June 18, 1987). A 1985 House of Representatives resolution criticizes the Vertical Restraint Guides for "qualifying the accepted rule that vertical price-fixing in any context is illegal per se." H.R. Res. 303, 99th Cong., 1st Sess., 131 Cong. Rec. H9324 (daily ed.) (1985). In August 1987, the Senate Judiciary Committee unanimously approved a Bill (S. 430) that would codify the principle that resale price maintenance is per se illegal. 53 ANTITRUST TRADE REG. REP. (BNA) 230 (August 18, 1987). The House Judiciary Committee approved a similar Bill (H.R. 585), in October 1987, 53 ANTITRUST & TRADE REG. REP. (BNA) 622 (October 22, 1987).

60 Bohling, *supra* note 11, at 502. Some have argued that another basis for the distinction is Congress' and the courts' belief that economic efficiency arguments are not valid for resale price maintenance. See, e.g., Pitofsky, *supra* note 34, at 15. Commentators have asserted that resale price maintenance is economically inefficient because there is no guarantee that a distributor will use a higher resale margin to provide increased services, (Comment, *Spray-Rite Service Corp. v. Monsanto Co.: The Justice Department Challenges the Per Se Rule Against Resale Price Maintenance*, 46 U. PITT. L. REV. 171, 192-93 (1984); see also Scherer, *supra* note 30, at 694) a manufacturer may mistakenly impose resale prices at too high a level or for too long a time (Hay, *Vertical Restraints After Monsanto*, 70 CORNELL L. REV. 418, 438 (1985); Steiner, *The Nature of Vertical Restraints*, 30 ANTITRUST BULL. 143, 181-82 (1985)), requiring higher resale prices overlooks the desires of consumers who want less services and lower retail prices (Comanor, *supra* note 39, at 992), and the practice injures the most innovative and efficient resellers, (Hovenkamp, *supra* note 6, at 7-8; Steiner, *supra*, at 153; Pitofsky, *supra* note 34, at 21-22; Pitofsky, *In Defense of Discounters: The No-Frills Case Against Vertical Price-Fixing*, 71 GEO. L.J. 1487, 1493 (1983)). Each of these arguments, however, could also be made against nonprice restrictions. These arguments also constitute a form of "second-guessing" whether a manufacturer has

Without a substantive economic basis for the price/nonprice dichotomy, the courts have fallen back on a formalistic analysis of price related vertical restraints that is confusing, conflicting, illogical and of limited value to practitioners and businessmen trying to plan their conduct. The legality of such restraints has turned not upon their economic effect or social impact but on a fine legal distinction between unilateral and concerted conduct.

In *United States v. Colgate Co.*,⁶¹ the Supreme Court established that a manufacturer may unilaterally announce a resale price maintenance policy and refuse to deal with distributors who fail to comply with the policy. The Court in *Monsanto* expressly revalidated the *Colgate* doctrine and pointed out that distributors are "free to acquiesce in the manufacturer's demand in order to avoid termination."⁶² However, there is a thin line between the *Colgate* right to unilaterally refuse to deal and the facts which will give rise to the inference of an illegal resale price-fixing conspiracy. Indeed, in *Monsanto* itself the Court inferred an illegal agreement when the distributor merely communicated to the manufacturer his acquiescence to the resale price program.⁶³

Many courts have inferred a vertical price-fixing agreement when resellers have been "coerced" into temporary compliance with manufacturer-imposed resale prices.⁶⁴ Because the type of conduct that courts will deem coercive is difficult to determine from the cases, businessmen have little guidance on how to implement and enforce vertical restrictions that have an effect on price. In *Kolling v. Dow Jones & Co., Inc.*,⁶⁵ the court inferred illegal resale price coercion merely from "threatening commands" made on the basis of the supplier's "superior bargaining strength."⁶⁶ Other cases, however, have given manufacturers much greater latitude. For example, in *Carbon Machine Tools Inc. v. American Tool Inc.*,⁶⁷ the court stated that it was permissible to announce suggested resale prices and to use persuasion, argument, and even pressure to convince the distributor to acquiesce.⁶⁸ Persuasion and monitoring of resale prices were also viewed indulgently in *Jack Walters & Sons Corp. v. Morton Building, Inc.*⁶⁹

The confused definition of coercion is not the only problem with the courts' current approach to resale price-fixing conspiracies. The distinc-

adopted a price restriction in the most efficient manner for a particular competitive situation. The arguments overlook *Sylvania's* understanding that a manufacturer's inherent desire for an efficient distribution system is generally sufficient to guarantee the maximum procompetitive effect on inter-brand competition and the minimum necessary reduction of intrabrand competition.

61 250 U.S. 300 (1919).

62 465 U.S. at 761. See also *Russell Stover Candies, Inc. v. Federal Trade Commission*, 718 F.2d 256, 260 (8th Cir. 1983).

63 465 U.S. at 765.

64 See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Black Gold, Ltd. v. Rockwool Industries, Inc.*, 729 F.2d 676, 686-87 (10th Cir.), cert. denied, 469 U.S. 854 (1984); *Yentsch v. Texaco, Inc.*, 630 F.2d 46 (2d Cir. 1980).

65 1982-83 Trade Cas. (CCH) ¶ 65,113 (Cal. Ct. App. 1st Dist. 1982).

66 *Id.* at p. 71, 230-71, 231.

67 678 F.2d 1253, 1261 (5th Cir. 1982).

68 678 F.2d at 1261.

69 737 F.2d 698 (7th Cir.), cert. denied, 469 U.S. 1018 (1984).

tion set forth in the cases between unilateral and concerted conduct is simply illogical. It is incongruous to have no illegal conspiracy when a distributor willingly complies with an announced resale price maintenance policy and an illegal conspiracy when the distributor unwillingly adheres to such a policy.⁷⁰ Such a distinction is certainly contrary to a layman's understanding of the term "agreement." The distinction also has little economic or social value, for the benefit or detriment to society does not depend on whether a distributor has willingly or unwillingly acquiesced in a resale price maintenance program.⁷¹ Indeed, the Supreme Court has expressly acknowledged that protected unilateral conduct under *Colgate* and illegal "coerced" resale price maintenance have the "same economic effect."⁷²

Without a logical economic or social basis, the cases involving resale price-fixing conspiracies present a confusing picture to practitioners and businessmen attempting to predict the type of business conduct that will be acceptable to the courts. Still another layer of complexity is added by the courts' traditional tendency to distinguish horizontal from vertical conduct. A series of Supreme Court cases has held that even nonprice restrictions will be subject to the per se rule when the restrictions originate from a horizontal combination at the resale level.⁷³ This approach carries the potential for attaching per se liability to the types of distribution systems validated in *Sylvania*.⁷⁴ The enforcement of legitimate non-price restraints, such as areas of primary responsibility, location clauses, and profit pass-over clauses,⁷⁵ may require rather extensive discussions among a manufacturer and his dealers. A plaintiff will attempt to use such discussions as *prima facie* evidence of a per se illegal horizontal conspiracy.⁷⁶ In *Monsanto* the Court reduced the risk to the manufacturer somewhat by holding that complaints from other distributors cannot alone support the inference of a conspiracy.⁷⁷ However, the manufacturer still runs a risk that communications with his distributors will be

⁷⁰ Kilbain, *Other Vertical Problems: Pricing, Refusals to Deal, Distribution*, 51 ANTITRUST L.J. 173, 179 n.21 (1982).

⁷¹ Brett, *supra* note 6, at 65; Hay, *supra* note 60, at 435.

⁷² *United States v. Parke Davis & Co.*, 362 U.S. 29, 44 (1960).

⁷³ *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (territorial restrictions); *United States v. General Motors Corp.*, 384 U.S. 127 (1966) (customer restrictions); *United States v. Topco Associates, Inc.* 405 U.S. 596 (1972) (territorial limitations). *But see* *Rothery Storage & Van Co. v. Atlas Van Lines Inc.*, 792 F.2d 210 (D.C. Cir. 1986), *cert. denied* —U.S.—, 107 S. Ct. 880 (1987). (arguing that the per se rule of *Topco* and *Sealy* for all horizontal restraints was effectively overruled when the Supreme Court applied the rule of reason to ostensibly horizontal restraints in *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979), *NCAA v. Bd. of Regents*, 468 U.S. 85 (1984), and *Northern Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985)).

⁷⁴ *Sylvania* did, however, cite *Topco* and recognized the need to distinguish between horizontal and vertical restraints. 433 U.S. at 58 n.28.

⁷⁵ Areas of primary responsibility require a distributor to meet certain sales obligations in a particular geographic area, but do not prohibit him from selling outside that territory. Location clauses merely establish the physical site from which a distributor may operate its business. Profit pass-over clauses require a distributor to pay compensation to adjacent distributors if he sells in their territories.

⁷⁶ Hay, *supra* note 60, at 434.

⁷⁷ See *supra* notes 47-52 and accompanying text.

sufficient to raise an issue of fact that will get a conspiracy case to the jury under a per se instruction.⁷⁸

Thus, the current formalistic approach of the courts recognizes a "double dichotomy" between price and nonprice restraints and between horizontal and vertical conduct. As a result, "virtually every plaintiff now alleges that nonprice restrictions are horizontal and that vertical restrictions are intended to control price."⁷⁹ Under this approach, many plaintiffs' attorneys are able to generate sufficient evidence of per se illegal conspiracies to avoid summary judgment and to obtain beneficial settlements even when no anticompetitive harm has occurred.⁸⁰

The courts' failure to develop a unified approach to vertical restraints has had a chilling effect on manufacturers' adoption of procompetitive vertical restraints.⁸¹ The distinctions between legal and illegal conduct are so unclear, and the consequences of miscalculation so severe, that many "decision makers will choose safer, although probably less efficient behavior."⁸² These distinctions obscure the insights of *Sylvania* into the efficiency rationale of vertical restraints. A manufacturer may, for example, wish to encourage his distributors to provide added services to customers. Areas of primary responsibility, location clauses, profit pass-over clauses, "airtight" territorial limitations,⁸³ suggested resale prices, express restrictions on resale prices and terminations of non-complying distributors are all possible methods of accomplishing such a goal. Each type of restriction may be motivated by the same procompetitive rationale and may have the same positive effect on interbrand competition and consumer welfare. Nevertheless, under the current formalistic approach, the legality of such restrictions will turn on whether they are perceived by judges and juries as price or nonprice-related or vertically or horizontally imposed. Circumstances over which a manufacturer has no control, such as a distributor's "willing" or "unwilling" acquiescence to certain of such restrictions, will also affect the legal outcome.

78 *Monsanto* did, after all, uphold a jury verdict against the manufacturer. 465 U.S. at 765. The Vertical Restraint Guides attempt to avoid this risk by validating vertical restraints even when dealers participate in decisions to enforce the restraints and communicate with the manufacturer concerning such enforcement. *Panel Discussion, supra* note 8 at 328 (comments of Rule). This author argued in a 1982 article preceding the *Monsanto* case for an analysis of the substantive competitive effect of vertical restraint cases having such a potential horizontal involvement by competing distributors. The suggested analysis looked to the manufacturer's motive, rather than to the outward horizontal or vertical form of the restraints, as determinative and asserted that a manufacturer should only be per se liable if he would not have taken action against a distributor "but for" the complaints of competing distributors. See Piraino, *Distributor Terminations Pursuant to Conspiracies Among a Supplier and Complaining Distributors: A Suggested Antitrust Analysis*, 67 CORNELL L. REV. 297 (1982).

79 Baker, *supra* note 26, at 1463.

80 *Business Electronics Corp. v. Sharp Electronics Corp.*, 780 F.2d 1212, 1222 (5th Cir. 1986) (Jones, J., concurring), *cert. granted*, —U.S.—, 107 S.Ct. 3182 (1987).

81 Sullivan, *supra* note 17, at 777; See also Kleine, *supra* note 30, at 1338.

82 Hay, *supra* note 60, at 430 n.65.

83 Airtight territorial limitations completely prohibit sales or shipments by distributors to locations outside their assigned geographic areas.

The distinctions which courts have drawn among these different types of behavior are difficult for businessmen to understand.⁸⁴ The outcome of litigation challenging vertical restrictions is also quite unpredictable, particularly when juries with little business experience are charged with making such obscure distinctions.⁸⁵ Indeed, one judge has characterized the current state of the law as the "Russian roulette approach to vertical price restraints."⁸⁶ Without clear guidance as to what conduct is legal, and faced with the potential liability of defense costs and treble damages,⁸⁷ manufacturers are reluctant to aggressively institute and enforce resale restrictions that promote customer services.⁸⁸ By placing manufacturers in peril of liability for adopting legitimate vertical restraints, the courts have deprived businessmen of the legitimate benefits of the *Sylvania* decision and made American manufacturers less competitive.

V. Economic Distinctions Among Vertical Restraints

A unified approach to vertical restrictions would avoid the chilling effect of the formalistic dichotomy currently followed by the courts. If all vertical restrictions could be distinguished on the basis of valid economic reasons instead of the current rules of thumb, truly anticompetitive conduct could be avoided without unnecessarily deterring legitimate vertical restrictions. One potentially unifying approach would be to distinguish all vertical restrictions on the basis of whether they were imposed by a single manufacturer or by a cartel.

The only valid economic distinction among vertical restraints is between restrictions adopted independently by a manufacturer, on one hand, and restrictions adopted pursuant to a horizontal cartel at the manufacturer or distributor level, on the other.⁸⁹ Manufacturer-imposed and cartel-imposed vertical restrictions have different impacts on consumers. Absent a cartel, a manufacturer will only impose vertical restrictions that he believes will increase demand for his product by providing services of additional value to consumers.⁹⁰ Distributors, however, have an inherent desire to avoid intrabrand competition, whether or not overall demand

84 The resale price-fixing precedent has been characterized as "an antitrust jurisprudence that is as comprehensible to all concerned as the Jabberwocky was to Alice." Cross-Petition for Writ of Certiorari at 7, *Business Electronics Corp. v. Sharp Electronics Corp.*, No. 85-2094.

85 Courts and commentators have cited the inability of courts to undertake the complex economic decisions required by such distinctions. See *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1213 (9th Cir. 1977); Posner, *supra* note 30, at 15; Easterbrook, *supra* note 30, at 25.

86 *Sharp Electronics*, 780 F.2d at 1222 (Jones, J., concurring).

87 The mere threat or filing of a lawsuit is often sufficient to convince a manufacturer to revoke or refrain from instituting a particular vertical restraint. Some manufacturers have actually agreed to continue to sell to distributors providing what they viewed as inadequate customer services in order to avoid expensive litigation, even though counsel may have advised they were likely to ultimately prevail in any lawsuit. Brett, *supra* note 6, at 51-52.

88 See Scherer, *supra* note 30, at 718. Manufacturers can be expected to be particularly wary of terminating distributors to enforce legitimate vertical restrictions, because antitrust claims have become "an almost reflexive response" to distributor terminations. Zeidman, *The Rule of Reason in Franchisor-Franchisee Relationships*, 47 ANTITRUST L.J. 873, 897 (1978).

89 See *Sharp Electronics*, 780 F.2d at 1221 (Jones, J., concurring); Hay, *supra* note 60, at 429; Posner, *supra* note 28, at 287.

90 See *supra* notes 28-30 and accompanying text.

for the product is increased.⁹¹ Restricted intrabrand competition allows distributors to obtain a greater percentage of profits even though the total profit pie shrinks.⁹² Dealer-imposed vertical restrictions thus lack the redeeming virtue of manufacturer-imposed restrictions: the promotion of interbrand competition. Without this beneficial effect, the naked suppression of intrabrand competition should not be tolerated.⁹³

There has been considerable discussion in the academic literature of the potential cartel-enhancing effects of vertical restrictions.⁹⁴ At the manufacturer level, cartels can be strengthened in several ways by resale price maintenance. Each member of a manufacturer price-fixing cartel may impose a fixed resale price level in order "to make the (cartel) pricing system more transparent, and, therefore, to make it easier to detect chiselling."⁹⁵ Individual manufacturers may be less likely to cheat the cartel and cut prices when dealers are unable to pass along the price cut to consumers and thereby increase demand for the manufacturer's product.⁹⁶ Finally, resale price-fixing eliminates the pressure which dealers may exert on manufacturers to reduce a cartel-imposed price.⁹⁷ In these ways, vertical price related restraints may stabilize interbrand supplier cartels. If the vertical restraints are incidental to such cartels, they should be as per se illegal as the horizontal price-fixing agreement itself.

At the distributor level, the cartelization distinction applies equally to price and nonprice restraints. Regardless of the type of restraint at issue, manufacturers acting independently will only impose vertical restrictions to increase their interbrand competitiveness, and dealers will more likely favor those restrictions that simply limit intrabrand competition. However, some commentators have argued that dealer cartelization is more likely with price than with nonprice vertical restraints. They point out that distributors who want greater profit margins may find it difficult to establish and police an intrabrand price-fixing cartel on their

91 Hay, *supra* note 60, at 418, 437.

92 *Id.* at 437.

93 The Court in *Sylvania* did not conclude that intrabrand competition was irrelevant despite its observation that interbrand competition is "the primary concern of antitrust law." 433 U.S. at 52 n.19. Indeed, the Court recognized that horizontally imposed restraints on intrabrand competition do not have the procompetitive justifications of other vertical restraints. 433 U.S. at 58 n.28. The Vertical Restraint Guides take the position that restrictions on intrabrand competition "generally represent" no anticompetitive threat. See Kleine, *supra* note 30, at 1339. The federal courts, however, have continued to hold that restrictions on intrabrand competition alone are sufficient to support a verdict against a defendant. See Graphic Products Distributors, Inc. v. Ittek Corp., 717 F.2d 1560, 1571-73 (11th Cir. 1983) (airtight territorial restrictions imposed by dual distributor); Com-Tel, Inc. v. Dukane Corp., 669 F.2d 404, 412 (6th Cir. 1982) (conspiracy among manufacturer and distributors to prevent resales to non-franchised distributors); Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 166 n.11 (3d Cir. 1979) (termination of price-cutting distributor at behest of competing distributor). Commentators have pointed out that intrabrand competition is worthy of protection because it encourages more efficient forms of retailing and forces manufacturers to adopt more innovative marketing policies. See, e.g., Steiner, *supra* note 60, at 174, 178.

94 See, e.g., Pitofsky, *supra* note 34, at 15-16; Markovits, *supra* note 17, at 81-82; Marks & Jacobson, *supra* note 27, at 248; Easterbook, *supra* note 37, at 141; Posner, *supra* note 6, at 7-8.

95 Scherer, *supra* note 30, at 691-92.

96 Phillips & Mahoney, *supra* note 27, at 105; Pitofsky, *supra* note 60, at 1490-91; Markovits, *supra* note 17, at 81-82.

97 Pitofsky, *supra* note 34, at 15-16. Although it did not fully explain its rationale, the Supreme Court may have had these cartel enhancing effects in mind when it stated in *324 Liquor Corp. v. Duffy*, 107 S. Ct. 720, 724 (1987) that resale price maintenance reduces interbrand competition.

own.⁹⁸ The distributors, therefore, approach the manufacturer and enlist his participation in the price-fixing scheme.⁹⁹ The manufacturer may acquiesce in the plan, even if it is contrary to his inherent desire for a high volume, low price resale policy, in order to retain his distributors' loyalty. With the ability to penalize distributors who sell at a lower price, the manufacturer can effectively enforce a fixed resale price.¹⁰⁰

The same arguments apply, however, to intrabrand customer or territorial restrictions. Such nonprice vertical restrictions, as well as resale price maintenance, can bolster dealer cartels.¹⁰¹ Distributors may be just as interested in limiting intrabrand competition through divisions of territories as by resale price-fixing, and the manufacturer's participation may be just as critical to the enforcement of such schemes. Horizontal divisions of territories enforced by distributors through a common supplier are as appropriate for per se treatment as horizontal price-fixing cartels enhanced in such a manner.¹⁰² The relevant economic distinction is thus not between vertical price and nonprice restraints, but between restraints imposed independently by a manufacturer and those imposed by a cartel at the dealer or manufacturer level.

The Antitrust Division and many commentators following the Efficiency Model have advocated a unifying rule of reason approach to all vertical restrictions. They point out that, absent a cartel, resale price maintenance has no greater anticompetitive effect than nonprice vertical restraints.¹⁰³ Because the circumstances in which a cartel imposes resale price maintenance are relatively rare¹⁰⁴ and can be easily identified,¹⁰⁵ there is no justification for a blanket per se rule that deprives manufacturers of the benefit of price related restrictions on distribution that may be procompetitive.¹⁰⁶

⁹⁸ Pitofsky, *supra* note 60, at 1490.

⁹⁹ See Marks & Jacobson, *supra* note 27, at 248.

¹⁰⁰ Comment, *supra* note 60, at 189. See also Easterbrook, *supra* note 37, at 141.

¹⁰¹ One commentator, in pointing out the economic equivalency of price and nonprice restraints, has argued that nonprice vertical restrictions, like resale price-fixing, can enhance a manufacturers cartel. Posner, *supra* note 6, at 7-8.

¹⁰² The Supreme Court has applied the per se rule not only when distributors have induced suppliers not to deal with discounters (*United States v. General Motors Corp.*, 384 U.S. 127 (1966)), but also when dealers have used a common supplier to enforce divisions of territories. *United States v. Topco Associates*, 405 U.S. 596 (1972).

¹⁰³ See Pitofsky, *supra* note 34, at 29-30.

¹⁰⁴ Manufacturer cartels promoting uncompetitively high levels of prices or customer services are inherently unstable, and manufacturers are likely to break away and go against the cartel policy. *Panel Discussion, The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 731, 738 (1983) (comments of Scherer). On the dealer level, effective price-fixing cartels are rare because a manufacturer confronted by a dealer cartel can often simply refuse to participate and, at the unconcentrated retail level where entry barriers are low, easily find substitute distributors. Baker, *supra* note 26, at 1507; Posner, *supra* note 30, at 24. The commentators have also argued that, to be effective, a dealer cartel must enlist all manufacturers of competing brands to participate; otherwise, other brands sold at a lower price would eventually drive the "cartelized brand" from the market. Posner, *supra* note 28, at 283 n.5; Baker, *supra* note 26, at 1489; F.H. Easterbrook, *supra* note 37, at 142; Scherer, *supra* note 30, at 711; Liebler, *supra* note 46, at 406.

¹⁰⁵ Scherer, *supra* note 30, at 715.

¹⁰⁶ In arguing that the per se rule for resale price maintenance should be overruled, some commentators have pointed out that the original decision invoking the rule, *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), could be viewed simply as a dealer cartel case. See, e.g., Hay, *supra* note 60, at 421. *Sylvania* noted the potential for manufacturer cartels as one rationale for

VI. Proposed Analysis of Vertical Restraints

A. *Manufacturer's Motive as a Determining Factor*

The most economically consistent way to distinguish among vertical restraints would be to view the manufacturer's substantive competitive motive as determinative in all circumstances.¹⁰⁷ If the manufacturer was instituting a restriction (whether price or nonprice) for his own independent reasons, the restriction could be assumed to promote inter-brand competition and would be entitled to favorable treatment. If the manufacturer's motive for implementing a vertical restriction, however, was merely to help further a cartel at either the dealer or manufacturer level, the restraint should be per se illegal as a garden variety horizontal restriction among competitors. Such a unified approach to vertical restraints would eliminate the courts' obscure and illogical distinctions between price and nonprice restraints and between unilateral and concerted conduct. As a result, manufacturers would no longer be deterred from implementing procompetitive vertical restrictions.

It is, however, unrealistic to expect the courts to adopt such a sweeping change to the current dichotomy between price and nonprice restraints. Congress has consistently indicated its intent that vertical price-fixing remain per se illegal.¹⁰⁸ The judicial precedent for the per se rule is well established, having been first enunciated in 1911,¹⁰⁹ reaffirmed in *Sylvania* in 1977 and approved both explicitly and implicitly several times in recent years.¹¹⁰ Despite the inroads of the Efficiency Model, many commentators continue to doubt that manufacturers can be relied upon to consistently promote consumer welfare with vertical restrictions. Adherents to the Interventionist Model persist in arguing that economic efficiency and pluralism are enhanced when resellers are allowed to price products as they see fit.¹¹¹ Therefore, it may be that our society is simply

the rule (433 U.S. at 51 n.18), and some commentators, attempting to read hopeful signs into *Mon-santo*, have asserted that the Court portrayed resale price maintenance "as a practice that may facilitate cartels." Popofsky & Bomse, *supra* note 29, at 97 n.89. The Supreme Court did explicitly recognize the cartel-enhancing potential of resale price maintenance in the recent case of 324 Liquor Corp. v. Duffy, 107 S. Ct. 720, 724 (1987). This recognition did not, however, cause the Court to abandon the per se rule. The Court, in fact, restated its view that resale price maintenance should be per se illegal. *Id.* at 725.

107 Some cases have recognized the importance of the manufacturer's motive to the analysis of vertical restraints. In *White Motor Co. v. United States*, 372 U.S. 253, 256-59 (1963), the Court expressly referred to the relevance of such motive. The *Sylvania* Court quoted from an early decision in *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918) which emphasized purpose over other relevant factors. 433 U.S. at 49 n.15. Indeed, by emphasizing the redeeming efficiencies of nonprice restraints, *Sylvania* implicitly found "purpose" to be a critical factor in the rule of reason analysis. Some subsequent lower court decisions have emphasized the importance of determining the manufacturer's motive for vertical restrictions. See, e.g., *Alpha Distributing Co. v. Jack Daniels Distillery*, 454 F.2d 442, 452 (9th Cir. 1972). Several commentators have pointed out that the reason for imposing a vertical restraint, rather than the form of the restraint itself, should be determinative. See Baker, *supra* note 26, at 1503; Hay, *supra* note 60, at 443; Piraino, *supra* note 78, at 298-99, 319.

108 The court in *Sylvania* cited such Congressional intent as one reason for retaining the per se rule against resale price-fixing. 433 U.S. at 51 n.18. See *supra* note 59, for a discussion of Congress' consistent position against resale price-fixing.

109 *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

110 See *supra* note 4.

111 See *supra* note 60.

not yet willing to allow manufacturers in all cases to dictate the resale price of their products subsequent to their initial sale.

There are also practical impediments to overruling the per se rule for all price related vertical restraints allegedly adopted by a manufacturer for independent reasons. In specific cases, it is often difficult to determine whether a manufacturer is imposing minimum resale prices for procompetitive reasons of his own or in response to the anticompetitive motives of a cartel.¹¹² The same types of restrictions that manufacturers may use to increase their competitiveness may also be desired by dealers simply to restrict intrabrand competition. It is impossible, for example, for a court to read a manufacturer's mind and determine whether the manufacturer is terminating a price-cutter to avoid free-riding or merely to eliminate intrabrand price competition.¹¹³ The courts' recognition of this problem may explain their failure to consider potentially redeeming motives of vertical restrictions in several cases.¹¹⁴ Indeed, the Court in *Monsanto* expressly referred to the difficulty of distinguishing procompetitive "vertical motives" from anticompetitive "horizontal motives," but it offered no real solution to the dilemma.¹¹⁵ The problem is compounded by the fact that evidence in modern anti-trust cases may not indicate a manufacturer's true competitive motive but instead may simply "reflect what counsel advise businessmen their purpose should have been."¹¹⁶

Intrabrand competition can benefit the consumer,¹¹⁷ and it is therefore important to insure that a manufacturer's motive for a vertical restriction is not simply to acquiesce in his distributors' desires to limit competition among themselves. The Supreme Court has recognized that restrictions on intrabrand competition can only be tolerated because of the countervailing positive impact on interbrand competition.¹¹⁸ Consumers are disadvantaged when a manufacturer imposes territorial restrictions or resale prices not to promote point-of-sale services but to protect his more established, less efficient dealers from competition. In such a case the territorial restrictions may be so ironclad, or the minimum resale price so high, that any resulting increase in consumer services may not compensate for the increase in resale prices. Because they lack any redeeming efficiency justifications, vertical restrictions imposed by manufacturers in response to dealer pressure can stifle the development of more efficient, low cost forms of retailing desired by consum-

112 Bohling, *supra* note 11, at 501-02.

113 Sharp Electronics, 780 F.2d at 1218; Valley Liquors, Inc. v. Renfield Importers Ltd., 678 F.2d 742, 744 (7th Cir. 1982).

114 See *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984) (per se illegality of inferred resale price maintenance agreement that may have been motivated by legitimate desire to avoid free-riders); *United States v. General Motors Corp.*, 384 U.S. 127 (1966) (per se illegality of restrictions on dealers' sales to discounters that may have reflected desire to assure customer services); *Eibeiger v. Sony Corp. of America*, 622 F.2d 1068 (2d Cir. 1980) (illegality of requirement that dealers selling outside assigned territory pay fee to supplier ostensibly to compensate dealer in other territory for warranty costs).

115 465 U.S. at 762-63.

116 Pitofsky, *supra* note 34, at 35. See also Posner, *supra* note 6, at 19.

117 See *supra* note 93.

118 See *Sylvania*, 433 U.S. at 54-55.

ers.¹¹⁹ Therefore, it is critical to distinguish such anticompetitive restrictions from those legitimately designed by the manufacturer to insure a more efficient distribution system.

Given society's continued support for the independence of resellers and the difficulty of determining a manufacturer's true motive for resale price restrictions, it is appropriate for the courts to fashion only a relatively limited exception to the per se rule against resale price-fixing.¹²⁰ A broader approach affording favorable treatment to resale price maintenance in all circumstances would be inconsistent with Congressional intent and Supreme Court precedent and would carry some risk of allowing undue restrictions on intrabrand competition.

A limited exception to the per se rule against resale price maintenance, however, is justified in those specific situations in which courts can be reasonably confident that a manufacturer has a legitimate procompetitive motive to promote customer services. The courts should be able to identify certain factors that would prove, in a clear and convincing manner, that a manufacturer's vertical restrictions were designed to promote interbrand competition and not to further a manufacturer or dealer cartel. Once such factors were proven, the courts could adopt a unified approach to any vertical restraints instituted by such a manufacturer. When a manufacturer can prove his independent procompetitive motive, the horizontal/vertical dichotomy becomes irrelevant because of the obviously vertical nature of the restraints. In such instances the current dichotomy between price and nonprice distinctions should also be abolished, for it makes no economic sense to deprive a manufacturer of the benefit of resale price controls that are truly intended to promote interbrand competition. When the manufacturer is attempting to make his distribution system more service oriented, the benefit to the consumer from price related restraints is clear, and prior precedent should not preclude a limited exception to the per se rule.¹²¹ Indeed, in such a case no further rule of reason inquiry would be necessary to prove the legality of the manufacturer's vertical restraints. This would then clear

119 Many consumers today rely on the lower prices of discount stores. A recent study by Senator Metzenbaum's staff indicated that in Ohio such prices are 18 percent to 30 percent less than in other stores. 52 ANTITRUST & TRADE REG. REP. (BNA) 810 (April 30, 1987).

120 Some commentators have suggested "modifying the per se rule at the edges to take account of justifiable exceptions." Pitofsky, *supra* note 34, at 1495.

121 Such an exception has already been recognized in recent cases in which the courts could identify clear benefits to consumers. See *AAA Liquors, Inc. v. Jos. E. Seagram & Sons, Inc.*, 705 F.2d 1203 (10th Cir. 1982) (upholding requirement that discount by manufacturer be passed through to purchasers), *cert. denied*, 461 U.S. 919 (1983); *Lewis Service Center, Inc. v. Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir. 1983) (upholding guaranteed minimum profit to dealer achieved through lowering of wholesale price), *cert. denied*, 467 U.S. 1226 (1984). Other cases have limited the application of the per se rule even when the benefit to consumers was not as apparent. See *Jack Walters & Sons Corp. v. Morton Bldgs, Inc.*, 737 F.2d 698 (7th Cir.) (permitting temporary pressure to adhere to advertised retail prices), *cert. denied*, 469 U.S. 1018 (1984); *Eastern Scientific Co. v. Wild Heerburgg Instruments, Inc.*, 572 F.2d 883 (1st Cir.) (resale price maintenance on sales outside territory upheld as ancillary to vertical non-price restraint), *cert. denied*, 439 U.S. 833 (1978); *Local Beauty Supply, Inc. v. Lamaur Inc.*, 787 F.2d 1197 (7th Cir. 1986) (denying recovery on theory terminated distributor not injured by resale price-fixing because its profits resulted from the minimum maintained prices); *Sharp Electronics*, 780 F.2d 1212 (5th Cir. 1986) *cert. granted*, 107 S. Ct. 55 (June 8, 1987); *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430 (7th Cir. 1986) (requiring proof of direct agreement on setting specific resale prices rather than mere elimination of price-cutter).

the way for a unified approach which affords a presumption of legality to any vertical restrictions implemented by manufacturers for the specific procompetitive motives validated by the courts. Such an approach would eliminate the price/nonprice and horizontal/vertical dichotomy in the most appropriate cases and would encourage manufacturers to adopt truly competitive vertical restraints.

B. *The Quality Motive for Vertical Restraints*

A manufacturer's desire to enhance the quality reputation of his products is one motive that is particularly appropriate for a presumption of legality. Quality related services at the distribution level are a critical competitive factor to manufacturers in today's economy. Presale product explanations and postsale warranty, repair, and training services provided in connection with a quality program clearly benefit the consumer. Vertical restrictions that encourage such services promote interbrand competition with a minimum adverse intrabrand effect. A manufacturer with a legitimate quality motivation will not be responding to the anticompetitive concerns of a manufacturer or dealer cartel. Furthermore, his independent motivation can be rather easily confirmed. Vertical restrictions designed to improve consumer information and services in connection with a manufacturer's quality program should therefore be afforded a presumption of legality.¹²²

The Efficiency Model assumes that demand for a product is determined not only by price but also by associated factors, such as quality related services, that add value to a product from a customer's perspective.¹²³ Manufacturers are willing to use vertical restrictions that raise resale prices only because they also encourage services that increase demand for a product.¹²⁴ The validity of this assumption is revealed by the recent experience of American manufacturers in competing with foreign producers in the quality area. As a result of that competition, quality has become as important a factor as price to many customers' purchasing decisions.

Prior to the mid-1970's, America's basic industries, including the steel, chemical and automobile companies, concentrated on producing

122 Many courts have upheld vertical restraints designed to improve quality and service. See *Sports Center, Inc. v. Riddell, Inc.*, 673 F.2d 786 (5th Cir. 1982) (restriction on resales to "bootleg" customers who might have damaged manufacturer's quality reputation); *Del Rio Distrib. Inc. v. Adolph Coors Co.*, 589 F.2d 176 (5th Cir.) (territorial restrictions necessary for quality control), *cert. denied*, 444 U.S. 840 (1979); *Richetti v. Meister Brau, Inc.*, 431 F.2d 1211 (9th Cir. 1970) (distributor termination for inadequate service), *cert. denied*, 401 U.S. 937 (1971); *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. 750, 758-59 (D. Md. 1980), (vertical restrictions designed to encourage presale product explanations and post-sale repair services), *aff'd* 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981). See also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 43-44 (1984) (O'Connor, J., concurring) (suggesting quality as well as price implications should be considered when restraint is challenged); *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 348-49 (1982) (implying that rule of reason should apply if quality of professional product or service is enhanced by price restraint).

123 The Efficiency Model would not view a vertical restraint as anticompetitive if it gave customers "something in addition that they wanted when they purchased a product; e.g., quality or service." Bock, *supra* note 6, at 137. See also Easterbrook, *supra* note 30, at 31.

124 See *supra* notes 28-30 and accompanying text.

the greatest possible quantity of goods at the lowest possible price.¹²⁵ In the mid-1970's foreign producers began to make significant inroads in American markets. The success of the foreign manufacturers was based as much on the superior quality of their products as on their lower price.¹²⁶ While American managers attempted to maximize their short term return on investment and minimize their financial risk, Japanese and German manufacturers were emphasizing technical excellence and investing heavily in product quality.¹²⁷ These foreign producers realized that they could use quality affirmatively as a competitive weapon and that it would translate directly into higher shares of the American market.¹²⁸

By the late 1970's, the availability of foreign products had made American consumers more aware of the advantages of quality.¹²⁹ Many consumers came to prefer higher priced foreign goods over less expensive American products because of their superior quality.¹³⁰ In fact, in the 1980's quality has become a more important competitive factor than price in many American industries.¹³¹ Because of consumer sensitivity to quality, manufacturers can increase their market share today just as effectively by improving quality as by reducing prices.¹³²

American manufacturers could overlook their customers' needs for quality as long as the reliability of their products was similar to that of other producers in the domestic market.¹³³ Investments in quality and product innovation seemed unnecessary to such manufacturers before the quality challenge from abroad.¹³⁴ However, the strategy of providing low cost products of minimal quality is no longer effective now that customers have the choice of purchasing higher quality foreign products. American manufacturers have therefore begun to reexamine all aspects of their business which impact product quality.¹³⁵ Despite recent improvements by American manufacturers, foreign producers remain significantly ahead in the quality race in many industries.¹³⁶ Foreign manufacturers continue to have a real competitive advantage over Amer-

125 Peters, *More Expensive, But Worth It*, U.S. NEWS & WORLD REPORT, Feb. 3, 1986, at 54.

126 D. HALBERSTAM, *THE RECKONING* 314, 457, 621 (1986).

127 *Winning the Quality Revolution*, TECHNOLOGY REVIEW, May/June 1982, at 80.

128 Cole, *The Japanese Lesson in Quality*, TECHNOLOGY REVIEW, July 1981, at 28-29.

129 *Capitalism and Quality*, FORBES, July 19, 1982, at 18.

130 See Peters, *supra* note 125 (citing consumers' willingness to pay \$3000 over list price and to wait six months for a Honda Accord); Sullivan, *supra* note 17, at 796.

131 See *Quality: The U.S. Drives to Catch Up*, BUSINESS WEEK, Jan. 1, 1982, at 66, 68 (citing consumers' preference for quality and reliability over price and concluding that "quality has replaced price as the key to improving market share."); Cole, *supra* note 128, at 29 (quoting consumer survey in which quality was cited as more important basis of purchase decision than price).

132 See, e.g., Peters, *supra* note 125, at 54. ("Changes in relative quality have a far more potent effect on market share than do changes in price."). The automobile companies' offering of more extensive warranties in early 1987 reflected their recognition of the importance of quality as a competitive factor. See Ingrassio, *U.S. Automakers Get Chance to Regain Sales From Foreign Rivals*, Wall St. J., Apr. 16, 1987, at 1, col. 5.

133 Cole, *supra* note 128, at 28.

134 D. HALBERSTAM, *supra* note 126, at 244-45.

135 *Panel Discussion, Counseling Your Client on Horizontal and Vertical Restraints*, 55 ANTITRUST L.J. 293, 305 (1986) (comments of Weinbaum).

136 D. HALBERSTAM, *supra* note 126, at 714.

ican firms because consumers still generally perceive products made abroad as superior in quality.¹³⁷

American producers have instituted new methods of purchasing, manufacturing, and distribution in an attempt to reduce the quality advantage of their foreign competitors.¹³⁸ Quality related services at the distribution level are critical to this effort. Distributors act as the manufacturer's representative to the public, and the quality of the services they provide significantly affects consumers' perception of the quality of the manufacturer's product. Indeed, such perception often is as much dependent on the associated services provided by a distributor as on the nature of the product itself.¹³⁹ Many consumers today associate quality with knowledgeable and helpful salespeople, prompt and effective warranty explanations and service, and the general reputation and image of the distributor selling a manufacturer's product.¹⁴⁰

A manufacturer is most likely to be concerned about insuring quality at the distribution level when his product is relatively complicated and differentiated from other brands. Under such circumstances both presale product explanations and postsale training and warranty repair services are necessary to preserve customers' good will.¹⁴¹

Customers may require extensive presale explanations in order to understand how complex products operate and to choose the particular specifications or optional accessories most appropriate for their needs. In order to insure the safe and effective application of complex products,

137 Blotnick, *If It's American, It Must Be Bad*, FORBES, Feb. 1, 1982, at 146; Berko, *Dollar's Deep Dive Fails to Halt Heavy Import Tide*, Cleveland Plain Dealer, Mar. 24, 1987, at 3-C, col. 1.

138 Flint, *Getting the Hang of the Thing*, FORBES, Dec. 2, 1986, at 42-43; Newton, *Developing the Mark of Excellence*, BLACK ENTERPRISE, Nov. 1985, at 55; *Detroit is Trying Harder for Quality*, BUSINESS WEEK, Nov. 1, 1982, at 77; *American Cars Are Getting Better*, CHANGING TIMES, Aug. 29, 1983, at 56; *Quality in the Making*, MONEY, Aug. 1981, at 40; *Are U.S. Cars Really Getting Better?*, U.S. NEWS & WORLD REPORT, Aug. 29, 1983, at 56.

139 See Takeuchi & Quelch, *Quality is More Than Making a Good Product*, HARV. BUS. REV., July-Aug. 1983, at 139, 142-43. The Germans and Japanese used good service as a primary weapon in their initial competition against the U.S. automobile manufacturers in the early 1970's. The Americans did not treat their customers with similar respect: "The burden of repair, often not very successful repair, seemed to fall on the customer." D. HALBERSTAM, *supra* note 126, at 424-25, 437.

140 See Silber, *The Legal Corner*, CONSUMER RESEARCH MAGAZINE, Mar. 1982, at 41. One recent survey found that only 14 percent of consumers switched automobile dealers because of dissatisfaction with the product itself, but 68 percent switched due to the "indifference" of sales people. Peters, *supra* note 125, at 54. Consumers today are flocking to distributors with a high quality image, from Wally's "Famous Amos" cookies to Banana Republic, Eddie Bauer, Benetton and Victoria's Secret. *Id.*

Quality related services at the distribution level are also important to industrial purchasers who have begun to "outsource" more of their components from domestic and foreign suppliers. Quick delivery is particularly important in industries that have adopted the "just in time" inventory approach, and sophisticated computer ordering systems and trained personnel are often necessary for distributors to insure such delivery. See *Distributors Switch Strategies to Survive Coming Shakeout*, Wall St. J., July 20, 1987, at 21; *Capital Goods Firms Enjoy Weak Dollar*, Wall St. J., June 10, 1987, at 6, col. 1. In fact, in the American industrial market there is currently a general "competitive trend toward quick response to customers" that will require more sophisticated services by distributors. *Why the Dollar Won't Bail Out Industry*, N.Y. Times, May 17, 1987, at F3, col. 1.

141 In *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. 750, 758-59 (D. Md. 1980), *aff'd*, 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981), the court upheld vertical restraints designed to encourage presale explanations and postsale repair services in the truck tire market. Proper selection of tires depended upon such factors as size, ply rating, intended load and speed, and road surfaces. The court emphasized distributors' need for "specialized knowledge" of such factors and the ability to perform repair and retreading services.

manufacturers will want experienced salespeople to guide customers in making their purchasing decisions. The manufacturer will expect such salespersons to promote the unique qualities of his product by explaining to customers how his product is preferable to other brands, how a higher price is justified by better quality, and how his warranty and post-sale service policies operate. The manufacturer's desire to insure such presale explanations corresponds with consumers' needs for information about complex products. Providing such information to customers facilitates comparison shopping and is in itself procompetitive.¹⁴²

Post-sale training and warranty repair services are also important to distribution level quality programs. Manufacturers may want distributors to offer customers lessons or training programs after they purchase products which require special skills to be effectively operated. Without such post-sales assistance, customers may never realize the full potential of complex products such as software, computers, musical instruments, or various electronic products. Post-sale warranty repair services are critical to the effectiveness of quality programs. Most manufacturers provide warranties to customers on complex operating products. Such warranties will be meaningless if local distributors are unable to provide prompt warranty repair services. A manufacturer will therefore want his distributors to employ specialized personnel with the experience and expertise to effectively perform such services.

The presale product explanations and postsale training and warranty repair services required for an effective quality program at the distribution level can be rather expensive. A manufacturer has a legitimate interest in guaranteeing to his distributors a sufficient resale margin to afford such services. Vertical restrictions designed to protect resale margins are thus appropriate when a manufacturer is attempting to implement a quality oriented distribution system.¹⁴³

American manufacturers' clear competitive need for quality motivated vertical restrictions helps insure that they will design such restraints to benefit consumers and not to promote a manufacturer or dealer cartel. A manufacturer concerned about quality at the distribution level is not likely to respond to the anticompetitive pressures of a dealer cartel. Indeed, the manufacturer's interest in promoting quality related services is often contrary to distributors' interests in maximizing their margins. The manufacturer receives a benefit from such services in the form of enhanced good will and a quality image for his product, but the distributor may only perceive that his margin is being reduced by expensive point-of-sale services. A manufacturer's goal under vertical restrictions is not simply to guarantee his distributors' margins but to insure that the distributors use such margins to promote and service his prod-

¹⁴² The FTC has concluded that quality becomes a competitive factor only if "substantial portions of consumers are informed." F.T.C. Policy Review Session, Consumer Information Remedies 44 (1979) (citing Morris & Bronson, *The Chaos of Competition Indicated by Consumer Reports*, 33 J. MARKETING 26 (1969); Sproles, *New Evidence on Price and Product Quality*, 11 J. CONSUMER AFF. 63 (1977)).

¹⁴³ See Popofsky & Bomse, *supra* note 29, at 90. Commentators have concluded that vertical restrictions are most likely to improve efficiency when complicated products are involved. See, e.g., Scherer, *supra* note 30, at 705.

ucts. In the absence of legal constraints, a manufacturer will therefore prefer vertical restrictions that increase competition among distributors in providing customer services. Such competition is obviously antithetical to the goals of a dealer cartel.

Manufacturer cartels are also unlikely in the case of vertical restrictions designed to promote quality related services. Product homogeneity facilitates collusion, but when products differ in design, style, quality, or cost, cartels are inherently unstable.¹⁴⁴ Collusion at the manufacturer level will be very difficult for the complex and differentiated products that require quality related services, and vertical restraints on the distribution of such products should pose little threat of enhancing a manufacturer cartel.¹⁴⁵

Therefore it would promote the competitiveness of U.S. manufacturers, with little attendant risk of anticompetitive consequences, to afford a presumption of legality to all vertical restrictions that are motivated by quality considerations. Because of the American consumer's current demand for quality, vertical restrictions which promote customer responsive services and a high quality image at the distribution level have a strong procompetitive interbrand effect. In the current competitive international climate, it is appropriate for the courts to recognize the positive effects of vertical restrictions implemented by a manufacturer to encourage quality related services to customers. The question then arises of what evidence the courts should require to insure that a manufacturer has the proper motivation to qualify for the "quality presumption."

C. *Proof of Quality Motivated Restrictions*

The evidentiary requirements for the quality presumption should be simple enough to avoid the chilling effects of the current approach and yet adequate to assure that manufacturers have a legitimate quality motive for vertical restrictions. Reasonable elements of proof for the quality presumption would include: (1) the existence of a formal quality program, (2) a product that requires quality related services and (3) the existence of interbrand competition that will be promoted by the vertical restraints. Each of these objective factors can be rather easily proven. Following such proof, the courts may reasonably assume a beneficial impact on interbrand competition and need not engage in further inquiries into the manufacturer's state of mind when he implemented a particular vertical restraint.¹⁴⁶

Requiring a manufacturer to prove the existence of a legitimate quality program should not deter him from adopting procompetitive vertical restrictions. With proper counsel, a manufacturer should be able to develop a record that proves the quality justifications of particular re-

¹⁴⁴ Bock, *supra* note 6, at 137; Phillips & Mahoney, *supra* note 27, at 104; Sullivan, *supra* note 17, at 787.

¹⁴⁵ Phillips & Mahoney, *supra* note 27, at 113-114.

¹⁴⁶ The courts' inability to do so has been a primary criticism of using the manufacturer's motive as a factor in the analysis of vertical restraints. See *supra* notes 112 to 116 and accompanying text.

straints.¹⁴⁷ A written policy indicating the manufacturer's concern for quality and the specific manner in which he intends to achieve quality objectives in distribution should generally suffice. The extent to which a manufacturer evidences concern about quality in other areas of his operations, such as purchasing and production, may indicate the genuineness of his motives. The manufacturer's consistency in enforcing quality related restraints also demonstrates how serious he really is about a quality related distribution system.¹⁴⁸

Before availing himself of the quality presumption, the manufacturer should be required to show that he is marketing the type of product that requires quality related explanations, training, or warranty and repair services at the distribution level. Such products will generally be rather complicated and differentiated from other brands by performance and cost. While food, clothing, and other fungible products would clearly not require quality related point-of-sale services, automobiles, electronic products, appliances, and other items with rather complicated operating components clearly would. When manufacturers distribute such complicated products under a legitimate quality program, vertical restrictions are appropriate to insure adequate resale margins for expensive point-of-sale services.¹⁴⁹ Furthermore, in such circumstances vertical restrictions are not likely to enhance cartelization at either the dealer or manufacturer level.¹⁵⁰

Increased interbrand competition is the very *raison d'être* of a legitimate system of vertical restraints. Restrictions on intrabrand competition under such a system are tolerable only because they promote interbrand competition. Interbrand competition is the critical factor which guarantees that a manufacturer will design vertical restraints to promote consumers' interests as efficiently as possible. Such competition acts as a natural "check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product."¹⁵¹ Vertical restrictions that cause higher prices or greater services than those desired by consumers will simply encourage other manufacturers to step in and fill the breach.¹⁵² A manufacturer

147 Bohling, *supra* note 11, at 516-17.

148 Panel Discussion, *supra* note 135, at 303 (comments of Weinbaum).

149 See *supra* note 143 and accompanying text.

150 See *supra* notes 141 to 145 and accompanying text. Some commentators have criticized vertical restrictions designed to create what they view as an unjustified differentiation among similar products. See, e.g., Hay, *supra* note 60, at 439. One commentator has characterized the debate over the legitimacy of such differentiation as "a moral or philosophical quarrel about the desirability of having \$30 sport shirts with alligators on the front." Baxter, *Vertical Practices—Half Slave, Half Free*, 52 ANTITRUST L.J. 743, 748 (1983). The complicated products required under the quality presumption should obviate such concerns. Different brands of complex operating products are naturally distinct in quality, reliability, and price. A manufacturer could not therefore use vertical restrictions to create an unjustified or noncompetitive differentiation among such brands. Instead, he would want to encourage his distributors to explain to consumers his products' legitimate advantages over the competition. Such explanations promote interbrand competition and are valuable to consumers.

151 Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 221 n.8 (D.C. Cir. 1986), *cert. denied*, 107 S.Ct. 880 (1987).

152 Bock, *supra* note 6, at 138-39; Hovenkamp, *supra* note 6, at 12. This phenomenon is evident in the history of the fair trade laws. Until Congress repealed the fair trade laws in 1975, resale price maintenance was legal in many states. Nevertheless, prior to 1975 the practice nearly disappeared in

aware of such potential actions by his competitors will attempt to use vertical restraints that most efficiently meet the needs of his customers.¹⁵³ If the manufacturer errs and adopts inefficient vertical restrictions, the market will correct the problem swiftly by encouraging new entrants, new distribution tactics by other manufacturers, or a different response by the manufacturer himself.¹⁵⁴ In the absence of interbrand competition, however, a manufacturer has less incentive to use efficient vertical restrictions. Thus, courts and commentators have pointed out that, as a manufacturer's market share increases and interbrand competition declines, it becomes more likely that vertical restraints will be used for cartel related purposes than for independent procompetitive motives.¹⁵⁵

A manufacturer should therefore be required to demonstrate the existence of interbrand competition before availing himself of the quality presumption. Monopolists or near-monopolists should not be able to take advantage of the presumption. If a manufacturer has sufficient market power to restrict output or raise prices on his own, he will not be competitively restrained from implementing inefficient vertical restrictions.¹⁵⁶ When the manufacturer is a monopolist or near-monopolist, intrabrand competition is the only kind of competition present and thus merits greater protection, particularly when improvements in the manufacturer's ability to compete at the interbrand level are unnecessary.¹⁵⁷

Although monopolists would not qualify for the quality presumption, firms with relatively high market shares should not be disqualified if they can demonstrate the other necessary evidentiary elements. Indeed, one could argue that the manufacturer should only be required to demonstrate that his market power falls short of monopoly proportions; i.e., that he lacks the power individually to restrict output or raise prices.¹⁵⁸ Without such market power, the manufacturer would presum-

industries in which consumers preferred lower prices to greater services because manufacturers with a low cost distribution policy stepped in to fill such demand. *Panel Discussion*, *supra* note 104, at 732-33 (comments of Scherer).

153 Hay, *supra* note 60, at 442.

154 Cf. *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982).

155 One commentator has argued that in highly concentrated industries it "becomes more likely that all the manufacturers will join in pursuing a high price/high margin policy" that restricts consumers' "low price choices." Scherer, *supra* note 30, at 704. See also Pitofsky, *supra* note 34, at 20-21; *Panel Discussion*, *supra* note 36, at 378 (comments of Reasoner); Note, *A Uniform Rule of Reason for Vertical and Horizontal Non-Price Restraints*, 55 S. CAL. L. REV. 441, 448 (1982). Others have pointed out that in concentrated, oligopolistic markets a series of parallel vertical restraints by different manufacturers can facilitate a tacit or implicit agreement to restrict interbrand competition. Hay, *supra* note 60, at 436 n.89.

156 It has been argued, however, that "even a monopolist would not employ nonprice restrictions if he thought consumers were going to be hurt because hurting consumers would hurt him as well." *Panel Discussion*, *supra* note 135, at 307 (comments of Turner). It could also be argued that, in markets with relatively low entry barriers, potential competition from new entrants would be sufficient to persuade even a monopolist only to use vertical restrictions beneficial to consumers. See Bock, *supra* note 6, at 137.

157 Pitofsky, *supra* note 34, at 35. But see White, *supra* note 28, at 330 (asserting that restraints imposed by monopolists may be "socially worthwhile" and that "the absence of interbrand competition may have little relevance for the evaluation of intrabrand competition").

158 This definition of market power was used by the district court in *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. 750, 761 (D. Md. 1980), *aff'd*, 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981). See Hay, *supra* note 60, at 443.

ably still feel restrained by actual or potential competition to limit his vertical restraints to those responsive to the needs of his consumers.

The primary purpose of the quality presumption is to encourage the use of procompetitive vertical restrictions by simplifying their judicial analysis. Requiring a complicated analysis of interbrand competition would defeat this purpose. Therefore the courts should adopt specific market thresholds for the quality presumption.¹⁵⁹ There is considerable justification for placing such a threshold as high as seventy percent. Even a manufacturer with such a high market share should not be able to restrict output or raise prices unreasonably.¹⁶⁰ When at least thirty percent of the market is controlled by other producers, a manufacturer has a real incentive to use the most efficient vertical restrictions. If he fails to do so, other manufacturers will provide the alternative distribution practices desired by consumers. The manufacturer's high market share should not raise cartel concerns because, under the other prerequisites for the quality presumption, the manufacturer will already have demonstrated his independent commitment to a quality program and the marketing of complex products that negate the likelihood of a manufacturer or dealer cartel.

D. *Presuming the Legality of all Quality-Motivated Vertical Restraints*

There is no justification for treating price and nonprice restraints differently once a manufacturer has proven the existence of a legitimate quality program, a product that requires quality related services and viable interbrand competition. Since both price and nonprice restraints enhance consumer services under such circumstances, they should be treated identically. Furthermore, in such cases courts should uphold any resale price restraints as ancillary to a procompetitive quality program designed to benefit consumers.¹⁶¹

159 The Vertical Restraint Guides advocate using a "market structure screen" for nonprice restraints. This requires consideration of: (1) the market share of the manufacturer, (2) the degree of market concentration at the resale level, and (3) the extent to which the restraint is used in the relevant market. The Antitrust Division argues that, if such indicators are each below certain thresholds, vertical restrictions are unlikely to be anticompetitive and therefore should not be challenged. See Section 4 of the Vertical Restraint Guides. The last market factor cited by the *Guides*, the market coverage of a particular restraint, is intended to reveal the likelihood of a cartel at the manufacturer or dealer level. See Easterbrook, *supra* note 30, at 30. This is a deficient indicator, however, because it overlooks the possibility that broad coverage for a particular restraint may simply reflect consumers' desire for more services (*Panel Discussion, supra* note 104, at 734 (comments of Popofsky)), makes the lawfulness of one manufacturer's conduct depend on what other manufacturers do and unfairly penalizes the last firms to implement a particular restraint. Hay, *supra* note 60, at 442 n.107.

160 See *Cowley v. Braden Industries, Inc.*, 613 F.2d 751 (9th Cir.) (upholding territorial restraint imposed by manufacturer with 70 percent of market) *cert. denied*, 446 U.S. 965 (1980). *But see* *Graphic Products Distributors, Inc. v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983) (75 percent market share sufficient to prove illegality). Some commentators have concluded that a market share of up to 70 percent can be tolerated for manufacturers implementing vertical restraints. See Baxter, *supra* note 150, at 751; Liebler, *supra* note 46, at 405 n.97.

161 Some cases have upheld resale price restrictions that were ancillary to distribution systems with legitimate nonprice elements. See *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir.), *cert. denied*, 439 U.S. 833 (1978); *Jack Walters & Sons Corp. v. Morton Bldgs., Inc.*, 737 F.2d 698 (7th Cir.), *cert. denied*, 469 U.S. 1018 (1984); *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430 (7th Cir. 1986).

A traditional rule of reason analysis is unnecessary, and even counterproductive, after a manufacturer has proven the elements of the quality presumption. Once a manufacturer has introduced such proof, no further competitive inquiry should be necessary to establish the legality of his vertical restraints. Cartel concerns would be obviated by proof of the manufacturer's independent competitive motive.¹⁶² With a legitimate quality motive, the manufacturer could be trusted to attempt to maximize his intrabrand competitiveness with the minimum adverse impact on interbrand competition. Competition from other manufacturers would ensure that the manufacturer only persisted in enforcing vertical restrictions in response to consumer demand. No further balancing of interbrand and intrabrand competitive effects under the *Sylvania* formulation would be necessary.

The clear evidentiary requirements for the quality presumption are superior to the vague standards of the rule of reason.¹⁶³ Although *Sylvania* recognized the efficiency benefits of nonprice vertical restraints, it gave no clear guidance as to how courts should balance such benefits against reduced intrabrand competition under the rule of reason.¹⁶⁴ There are no clear standards on how courts should decide rule of reason cases, but "only a checklist of factors to which different triers of fact give different weights."¹⁶⁵ The courts are incapable of weighing such factors in a manner that conveys predictable results.¹⁶⁶ This uncertainty encourages the filing of frivolous lawsuits. Indeed, nonprice vertical restrictions adopted for ostensibly procompetitive motives may still be found illegal under the uncertain standards of the rule of reason.¹⁶⁷ Rule of reason

162 Some commentators have argued that the efficiencies of vertical restraints justify presuming their legality, except when imposed by cartels. See, e.g., Posner, *supra* note 30, at 22-23.

163 Commentators have argued that presumptions in favor of certain vertical practices would be preferable to the "largely formless rule of reason." Popofsky and Bomse, *supra* note 29, at 94. A few courts have recently been receptive to replacing a full rule of reason analysis of vertical restraints with rules of presumptive legality for firms with low market shares. See, e.g., Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742 (7th Cir. 1982), *aff'd* 822 F.2d 656, *cert. denied*, 108 S. Ct. 488 (1987); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 698 F.2d 1011 (9th Cir.), *cert. denied*, 464 U.S. 829 (1983); Sports Center, Inc. v. Riddell, Inc., 673 F.2d 786 (5th Cir. 1982); Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md.), *aff'd*, 638 F.2d 15 (4th Cir. 1980), *cert. denied*, 454 U.S. 864 (1981).

164 433 U.S. at 55. The authoritative statement of the rule of reason was made in *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918). The case listed several factors, including the effect of a restraint on competition, market history, the motive for the restraint, the nature and effect of the restriction itself, and the condition of the market before and after the restraint was imposed. No guidance was given, however, as to the relative weight to be ascribed to each factor in this open ended formula. The *Sylvania* Court failed to clarify the issue when it cited *Chicago Board of Trade* without any indication of the relevance or weight of any particular factor. 433 U.S. at 49-50 n.15.

165 Posner, *supra* note 30, at 17-18. The Vertical Restraint Guides attempt to "structure" the rule of reason to make it more efficient. See *supra* note 159. But even the rule of reason approach of the *Guides* has been criticized for potentially requiring "wide ranging discovery" and a complicated economic analysis. Kleine, *supra* note 30, at 1367.

166 "Of course judges cannot do what such open-ended formulas require. When everything is relevant, nothing is dispositive." Easterbrook, *supra* note 37, at 155. A sixteen page monograph by the A.B.A. in 1977 (ABA Antitrust Section, Monograph No. 2, "Vertical Restrictions Limiting Interbrand Competition," at 55-57) indicates the "formlessness" of the rule. Posner, *supra* note 6, at 16.

167 *Sylvania* did not adopt a standard of per se legality for such restraints. See Hay, *supra* note 60, at 428. A well-financed and determined plaintiff can still win under the *Sylvania* formulation. See *Graphic Products Distributors, Inc. v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983) (refusing to set aside jury verdict in favor of plaintiff in airtight territorial restraint case); *Eiberger v. Sony Corp.* of

antitrust cases are long, complicated and expensive because of the myriad issues of fact raised under the analysis. Thus, even when manufacturers are confident that they are terminating distributors to enforce valid vertical restrictions, they must "weigh the costs of almost certain litigation" involving endless discovery.¹⁶⁸ These risks deter manufacturers from using and enforcing even the nonprice vertical restrictions validated in *Sylvania*.¹⁶⁹

The suggested evidentiary requirements for the quality presumption avoid such chilling effects. The presumption provides a rather simple and easily understood "safe harbor" to businessmen with legitimate quality objectives. Under the suggested approach, counsel can easily advise businessmen of what conduct does not create risks of liability. Litigation costs would be reduced as defendants could either predicate motions for summary judgment on the requisite proof for the quality presumption or, in the worst case, limit discovery to such factors. Spurious lawsuits would be reduced as the courts made it clear that they would grant defendants a presumption of legality upon proof that vertical restrictions were quality motivated. Such an approach would finally free manufacturers to reap the promise of *Sylvania* and implement vertical restrictions which improve their competitiveness and provide consumers with the desired level of quality related services.

E. *Specific Vertical Restraints and the Quality Presumption*

A manufacturer may use several different types of vertical restrictions to promote presale product explanations and postsale warranty, repair and training services by his distributors under a quality program. These range from areas of primary responsibility, location clauses, and profit pass-over clauses to "airtight" exclusive territories and resale price maintenance. Under the current approach, manufacturers can only implement the least restrictive of these restraints with reasonable confidence in their legality.¹⁷⁰ However, in certain situations airtight exclusive territories and resale price maintenance may be the manufacturer's most efficient means of promoting quality related services. The suggested quality presumption would free manufacturers to use such restraints in connection with legitimate quality programs. The following analysis of the specific procompetitive effects of these restrictions under a quality program demonstrates the validity of the presumption.

America, 622 F.2d 1068 (2d Cir. 1980) (illegality of warranty fee pass-over arrangement used to enforce territorial restrictions).

168 Testimony of Joseph P. Creighton, Vice President, Harris Corporation, before U.S. Senate Antitrust Subcommittee, quoted in *Moms, Others Back Discounters' Bill*, THE CLEVELAND PLAIN DEALER, April 24, 1987, at 14-B, col. 1.

169 Posner, *supra* note 30, at 15-16, 22-23.

170 Only one case since the *Sylvania* decision in 1977 has found a non-airtight territorial clause illegal. See *Eibeiger v. Sony Corp. of America*, 622 F.2d 1068 (2d Cir. 1980). In the automobile industry all products are sold through dealers subject to location clauses in order to discourage free-riding and encourage customer services. One commentator has stated that he "cannot conceive" why such location clauses should be impermissible. *Panel Discussion, supra* note 104, at 733 (comments of Popofsky).

1. Nonprice Restrictions

Although *Sylvania* applied the rule of reason to nonprice vertical restraints, it did not hold that all such restraints are legal per se.¹⁷¹ A manufacturer is still subject to an interbrand/intrabrand balancing test that will determine the ultimate legality of nonprice restraints. In some cases the manufacturer can still lose despite *Sylvania's* efficiency rationale.¹⁷² The risk of ultimate liability is particularly high when a manufacturer uses severely restrictive vertical restraints such as airtight territorial clauses.¹⁷³ Because intrabrand competition is effectively eliminated under airtight territorial clauses, such clauses have been found illegal in some cases,¹⁷⁴ and one commentator has even argued that they should be per se illegal.¹⁷⁵

There is no good reason after *Sylvania* to deny a manufacturer the benefit of any nonprice vertical restraints designed to enhance his quality *vis a vis* other brands. Once the manufacturer's quality motive is proven, it can be assumed that any such restrictions will only be used to encourage services desired by consumers. A manufacturer will not want to limit intrabrand competition any more than is necessary to guarantee such services.¹⁷⁶ Manufacturers will, therefore, generally prefer areas of primary responsibility, location clauses, and profit pass-over clauses to airtight territorial clauses. Areas of primary responsibility and location clauses assure that distributors adequately service a targeted area but still allow for some intrabrand competition among neighboring distributors. Similarly, profit pass-over clauses can help to compensate distributors for losses of sales to free-riders without completely eliminating competition among distributors in different territories.¹⁷⁷ A manufacturer will generally want to preserve as much of such competition as possible in order to give his distributors an incentive to service customers more efficiently.

Areas of primary responsibility, location clauses, and profit pass-over clauses, however, do not completely prevent a distributor from free-riding on quality related services provided by neighboring distributors. Under each such restriction, free-riders are still able to compete with full service distributors. A manufacturer may conclude that airtight territories are necessary for complex products requiring expensive quality related services that might disappear under a free-rider assault. When complete protection against free-riders is necessary under a quality pro-

171 433 U.S. at 57-59. Some commentators have argued for a rule of per se legality for nonprice vertical restrictions. See, e.g., Posner, *supra* note 30.

172 See *supra* note 167 and accompanying text.

173 Even profit pass-over arrangements carry a risk of liability. It has been alleged that such clauses limit the incentive for a distributor to sell outside his territory. A profit pass-over arrangement was found to be illegal in *Eibeiger v. Sony Corp. of America*, 622 F.2d 1068, 1076-81 (2d Cir. 1980). See also *Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.*, 585 F.2d 821, 829 (7th Cir. 1978), (noting jury could have found pass-over fee to be unreasonable), *cert. denied*, 440 U.S. 930 (1979). But see *Superior Bedding Co. v. Serta Assocs., Inc.*, 353 F. Supp. 1143, 1150-51 (N.D. Ill. 1972) (upholding pass-over fee).

174 See, e.g., *Graphic Products Distributors, Inc. v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983).

175 Pitofsky, *supra* note 34, at 28.

176 See *supra* notes 28-30 and accompanying text.

177 Pitofsky, *supra* note 34, at 23.

gram, airtight clauses are justified by their promotion of interbrand competition.

It is safe to assume that, in using airtight clauses, a manufacturer with a legitimate quality motive is not responding to the anticompetitive pressures of a cartel but is simply pursuing what he perceives as his own best interests. It would be unfair, as suggested by some commentators, to second guess whether an airtight clause was the least restrictive alternative available to such a manufacturer.¹⁷⁸ The test of the quality presumption is not whether a vertical restriction achieves the optimum results that judges or juries can imagine but whether the manufacturer implemented the restriction in good faith for an independent competitive motive. Once such a motive is established by evidence of a legitimate quality system, courts should give the manufacturer's decision the benefit of the doubt. If the manufacturer's airtight territorial restrictions are truly a less efficient alternative, the market will correct his mistake more quickly and effectively than could most courts.

2. Resale Price Restrictions

Minimum resale price maintenance may be instituted by a manufacturer under a quality program for the same procompetitive rationale as the nonprice restrictions described above.¹⁷⁹ A manufacturer may require fixed resale prices to prevent free-riding on presale product explanations and postsale training or warranty and repair services¹⁸⁰ and to encourage competition among his distributors in such quality related services. In fact, resale price maintenance is a more precise and efficient means than nonprice restrictions for encouraging such services. By adjusting the resale price level, the manufacturer can "choose any level of point-of-sale services that he desires his dealers to provide."¹⁸¹ It is

178 Some commentators believe that manufacturers should be held to a standard requiring them to use the "least restrictive alternative" to accomplish their competitive objectives. See, e.g., Seiberling, *supra* note 59, at 180; Steiner, *supra* note 60, at 188. Such a standard has been criticized, however, as a form of "second-guessing" that places "a defendant at the mercy of the imagination of the plaintiff's lawyers." Bohling, *supra* note 11, at 516. See also Pitofsky, *supra* note 34, at 36-37; American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230, 1249 (3d Cir. 1975) (stating that under this rule manufacturers would "be made guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question that would result in a somewhat lesser restriction of trade.").

179 A manufacturer may also want to use *maximum* resale price-fixing under a quality program. If distributors are granted airtight exclusive territories in order to promote quality related services, maximum resale price maintenance could prevent price gouging of customers. Although maximum price-fixing is currently grouped with minimum resale price maintenance under the *per se* rule, the arguments for allowing maximum resale price fixing after *Sylvania* are even more persuasive. See *supra* note 34.

180 Some commentators have argued that the free-rider justification does not apply when a manufacturer wishes to encourage postsale warranty and repair services under a quality program. They point out that consumers generally will not buy a product from one distributor and then go to another distributor for warranty repairs. Comanor, *supra* note 39, at 987. However, even if they do, the manufacturer's warranty will require repair services at either distributor. *Panel Discussion, supra* note 104, at 735 (comments of Scherer). This argument overlooks the importance of presale explanations of warranty terms and conditions and product characteristics as well as the need to insure a sufficient margin so that each distributor employs enough trained specialists to perform warranty and repair services in an effective manner.

181 Posner, *supra* note 28, at 294. See also Baker, *supra* note 26, at 1465 n.37. One commentator has argued, however, that resale price maintenance is a "blunt instrument" that may set "too high a

much more difficult to draw territorial lines or customer restrictions in a manner that will encourage precisely the level of necessary point-of-sale services. This is particularly true in the case of quality programs for complex products which require extensive presale product explanations and postsale training or warranty and repair services.

Resale price maintenance is the only vertical restriction other than airtight territorial clauses that can completely prevent free-riding.¹⁸² When airtight territorial clauses are not feasible (e.g., when effective distribution of a product requires numerous distributors located closely together), resale price maintenance is the manufacturer's only means of guaranteeing his distributors free-rider protection. From an antitrust standpoint, resale price maintenance is superior to airtight territorial clauses because it remedies the free-rider problem in a less restrictive way.¹⁸³ By controlling the resale price, the manufacturer need not eliminate all intrabrand competition, as he must under an airtight clause. Instead, he moves the arena of competition from the price to the service area.¹⁸⁴ Without airtight territorial protection, resale price maintenance forces distributors to step up competition among themselves in point-of-sale services that enhance product quality.¹⁸⁵ It may well be to the manufacturer's advantage to have his distributors compete in meeting customers' demands for service under a quality program, rather than to have them completely insulated from intrabrand competition. Indeed, such intrabrand nonprice competition benefits both the manufacturer and his customers by giving distributors a greater incentive to provide the most efficient and desirable point-of-sale services. Such an incentive may be particularly important to a manufacturer who is marketing complicated products that require highly paid specialists for presale explanations and/or postsale training or repairs. Unless they are forced to compete among themselves to meet customers' service needs, distributors may simply decline to hire such specialists.

Despite the advantages of resale price maintenance, some commentators argue that the practice should not be allowed even for manufacturers with a procompetitive intent to promote consumer services. Such commentators point out that resale price maintenance is generally inefficient and does not guarantee that services will actually increase (the dis-

price for some people and too low a price for other people" and that territorial restrictions are more efficient. *Panel Discussion, supra* note 104, at 736 (comments of Scherer).

182 *Panel Discussion, supra* note 135, at 295 (comments of Turner). See Posner, *supra* note 30, at 11-12.

183 A few courts have recognized that resale price maintenance has no greater anti-competitive effect than airtight territorial clauses. See *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430, 1439 (7th Cir. 1986) ("When it is lawful to forbid all competition between two dealers, . . . a limitation on price competition between the same dealers - a lesser limitation - can have no effect."); *Eastern Scientific Co. v. Wild Heerburgg Instruments, Inc.*, 572 F.2d 883, 885 (1st Cir.) ("resale price restrictions used to enforce the assigned territories in the present case cannot possibly have a greater anti-competitive effect"), *cert. denied*, 439 U.S. 833 (1978); *Hochstadt v. Worcester Foundation*, 545 F.2d 222 (1st Cir. 1976) (requirement that dealer charge list price or higher on sales outside assigned territory should be judged by rule of reason).

184 Sullivan, *supra* note 17, at 799.

185 Posner, *supra* note 28, at 284.

tributor may merely "pocket" his guaranteed margin).¹⁸⁶ They argue that manufacturers tend to deal with high margin retailers for too long a time, become locked into providing more services and higher prices than desired by consumers and end up stifling more efficient low-cost retailers.¹⁸⁷ They also emphasize the availability of "less restrictive alternatives," including direct subsidies or contractual requirements for services which leave the distributor free to price the product as he sees fit,¹⁸⁸ unilaterally refusing to deal with price-cutters under *Colgate*, or simply lowering wholesale prices to increase dealer margins to the level at which point-of-sale services are economic.¹⁸⁹

These arguments against resale price maintenance amount to a form of unfair second-guessing of a manufacturer with a legitimate quality motive. In fact, the same arguments could be made against the types of nonprice vertical restrictions validated in *Sylvania*. A manufacturer with a legitimate quality motive will only use resale price maintenance, like the nonprice restraints at issue in *Sylvania*, if he believes such price maintenance is the best way to increase demand for his products.¹⁹⁰ If the manufacturer makes a mistake and adopts resale price restrictions that result in higher prices and more services than desired by consumers, the market will encourage other manufacturers to meet such consumers' demand for lower prices and less services.

Competitive markets enforce economic efficiency more effectively than courts. It is easy, in a theoretical vacuum, to devise "less restrictive alternatives" to resale price maintenance that may not be effective in practice. Indeed, there are many reasons why the alternatives suggested above may not be available to certain manufacturers. Contractual restrictions and subsidies are difficult to police and burdensome to implement (by contrast, resale price maintenance is a more market-oriented way to encourage quality related services),¹⁹¹ the *Colgate* right to unilaterally refuse to deal subjects manufacturers to potential liability for treble damages,¹⁹² and reducing wholesale prices limits the manufacturer's margin without guaranteeing that free-riders do not simply discount to a lower net level.

Some commentators have a more fundamental objection to resale price maintenance. They claim that the practice may create and perpetuate an unjustified differentiation among products. Manufacturers may use resale price maintenance to insure that products with no inherent quality advantage project a high quality image through their association with high margin retailers. Since differentiation based on image rather

186 See Marks & Jacobson, *supra* note 27, at 248-49.

187 Steiner, *supra* note 60, at 177; *Panel Discussion*, *supra* note 104, at 733, 737 (comments of Scherer).

188 See Bohling, *supra* note 11, at 509; Pitofsky, *supra* note 60, at 1493; Steiner, *supra* note 60, at 188; Seiberling, *supra* note 59, at 180.

189 Pitofsky, *supra* note 60, at 1494.

190 The practice may in fact be the best way to enhance nonprice intrabrand competition and thereby encourage distributors not to retain their guaranteed margin but to use it to provide more of the services desired by consumers. See *supra* note 37 and accompanying text.

191 White, *supra* note 28, at 338.

192 See *supra* notes 61-69 and accompanying text.

than actual product characteristics does not enhance consumer value, resale price maintenance should not be allowed in such situations.¹⁹³ This argument is deficient in several respects. Because it can be applied to any vertical restrictions, the argument contradicts the *Sylvania* holding that benefits to interbrand competition (regardless of their effect on product differentiation) justify vertical restrictions. The argument is particularly inapplicable to resale price maintenance used for quality related reasons. For one thing, a quality image may have real value to many consumers.¹⁹⁴ Also, the interbrand competition required under the quality presumption guarantees that other manufacturers can meet the demand of consumers who prefer lower prices to a quality image. Finally, under the quality presumption, products will be rather complicated and naturally differentiated from other brands by cost, performance and quality characteristics. Therefore, there can be no question that resale price maintenance is being used to create other than legitimate differentiations among products.¹⁹⁵

3. Advantages of Unified Approach

The procompetitive effects of each of the above vertical restrictions reveal the appropriateness of the quality presumption. Price and non-price restraints used by manufacturers to enhance quality in a competitive market all have beneficial interbrand effects. Absent legal constraints, the manufacturer will choose the particular vertical restraint that he believes will most efficiently improve his competitiveness against other brands. The characteristics of the manufacturer's product, the nature of his distribution network, the desires of his customers, the state of his competition, and the quality objectives which he wishes to accomplish are all factors which will influence his decision. Airtight territorial restrictions, less restrictive customer or territorial restraints or resale price maintenance may all be more or less appropriate in the circumstances. Manufacturers who meet the evidentiary requirements of the quality presumption can be relied upon to weigh these factors and decide upon the most efficient alternative. It is such manufacturers, and not judges or juries, who best understand their markets and who are at economic risk if

193 The argument is made despite the fact that image creating activities are subject to free-riding. See Hay, *supra* note 60, at 444; Bohling, *supra* note 11, at 506-07. In response to this argument, several commentators have pointed out that manufacturers have legitimate competitive reasons for attempting to enhance their quality image at the distribution level. See Pitofsky, *supra* note 60, at 1494 (manufacturers want to prevent use of their product as a "loss leader"); Popofsky & Bomse, *supra* note 29, at 92-93 (retailers may be able to signal high quality of stylishness of goods more cheaply than manufacturer); Scherer, *supra* note 30, at 695 (retailer "certifies" to consumer that he has incurred costs of selecting quality goods); Baxter, *supra* note 150, at 748 (manufacturer encourages retailer to sell more high quality goods when he protects his margin through resale price maintenance).

194 One commentator has pointed out that "the notion that creating a favorable image for a product . . . does not benefit consumers is based on a value judgment that not all economists share." Hay, *supra* note 60, at 439. In *Sylvania* the Court rejected the product differentiation argument by pointing out that promotional efforts resulting from vertical restrictions may "convey socially desirable information about product availability, price, quality, and services." 433 U.S. at 56 n.25.

195 See *supra* notes 141-142 and accompanying text.

they make the wrong decision. Their decisions on the adoption of vertical restraints should therefore be afforded a presumption of legality.

The simplicity of the quality presumption will enable manufacturers to promote customer services at the distribution level without fear of liability. They will no longer be subject to potential judgments on the basis of vague distinctions between price and nonprice or horizontal and vertical conduct. Manufacturers will be free not only to implement but to aggressively enforce quality motivated restrictions. This will reduce the "hurdle" for terminating distributors who attempt to circumvent quality programs.¹⁹⁶ Distributors will not be able to increase the costs and risks of litigation by alleging per se illegal resale price maintenance or horizontal conspiracies. Once the manufacturer introduces the evidence that raises the quality presumption, he can be confident that his termination of a noncomplying dealer will not be found illegal merely because of his discussions with other distributors, suggestion of particular resale prices, or other circumstances that do not bear on the legitimacy of his competitive motives. The chilling effect of the current judicial approach, which discourages manufacturers from adopting and enforcing procompetitive vertical restraints, will then be eliminated for manufacturers with legitimate quality programs.

VII. Conclusion

The current dichotomy between price and nonprice vertical restrictions cannot be justified on economic grounds. The dichotomy has done significant damage to the competitiveness of American manufacturers by discouraging them from adopting vertical restrictions that promote customer services. Nevertheless, it is unlikely that the courts would adopt and that Congress would permit a broad unified approach to vertical restrictions. A limited exception to the per se rule against resale price maintenance, however, may be acceptable in specific situations in which the courts can be certain of a manufacturer's procompetitive motive. The quality related motive for vertical restrictions is particularly appropriate for such an exception. Manufacturers who qualify for the quality presumption are likely to be market-driven to deliver products and services to consumers in the most efficient manner possible. Such manufacturers should be freed from the confines of the current formalistic approach and allowed to implement and enforce vertical restrictions that enhance consumer welfare. The best way to do so is by affording a presumption of legality to any price or nonprice vertical restrictions that manufacturers implement in competitive markets for the purpose of enhancing the quality of their products.

¹⁹⁶ One court recently cited the problems inherent in the current judicial approach, under which a manufacturer may be "potentially held accountable in treble damages for terminating a distributor who . . . failed to market its product adequately." *Sharp Electronics*, 780 F.2d at 1221 (Jones, J., concurring).