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Rethinking the "Agreement" Element in Vertical Antitrust Restraints

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I. INTRODUCTION

Vertical restraints in antitrust have been a messy area of the law for some time. Over the years, the U.S. Supreme Court has created a body of caselaw full of Byzantine twists and turns and hair-splitting distinctions that perhaps gladden the hearts of law professors but confound (if not dumbfound) the practitioner and business person.[1]

A number of commentators have argued that the confusion, if not outright inconsistency, in the area of vertical restraints stems from the Supreme Court's failure to base its decisions on a coherent view of the policy or policies to be advanced by the antitrust laws.[2] This is certainly true. But it is not the whole

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1. Scholars have lamented for some time about the confusion in the law of vertical restraints. *See, e.g.*, R. BORK, THE ANTITRUST PARADOX 280 (1978) ("The law of resale price maintenance and vertical market division is not only at war with sound antitrust policy but is decidedly peculiar even on its own terms."); R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 164 (1976)
(Vertical cases "are an intellectual failure of imposing dimensions.") [hereinafter R. POSNER, ANTITRUST LAW]; Baker, *Interconnected Problems of Doctrine and Economics In the Section One Labyrinth: Is* Sylvania *a Way Out?* 67 VA. L. REV. 1457, 1457 (1981) (The vertical restraint rules "are a jumble of pieces that simply do not fit together."); Baxter, *The Viability of Vertical Restraints Doctrine*, 75 CALIF. L. REV. 933, 933 (1987) ("The vertical rules have had a chaotic, an anti-intellectual, and, in some senses, a belated development.").

2. *See, e.g.*, Hay, *Vertical Restraints After* Monsanto, 70 CORNELL L. REV. 418, 418 (1985):

> [T]he Supreme Court has been reluctant to apply a comprehensive analysis to vertical restraints of trade. Rather, in each case it has applied a simple principle or rule of thumb to a discrete aspect of the vertical restraint problem. Because of its piecemeal approach, the Court has failed to appreciate the incompatibility of these various principles.

Id. (footnote omitted). *See* R. BORK, *supra* note 1, at 289 ("Vertical restraint law has reached its present unhappy state because the Supreme Court is struggling with the logical results of an incorrect premise laid down sixty years ago . . . in the *Dr. Miles* opinion."); Popofsky & Bomse, *From* Sylvania *to* Monsanto: *No Longer a "Free Ride,"* 30 ANTITRUST BULL. 67, 68 (1985) (the vertical restraint decisions "reflect a struggle to deal with an emerging economic consensus while attempting—often in the most plainly Procrustean fashion—to preserve competing political values and accommodate a judicial reluctance to embrace theoretical models which strike many judges as a bit too self-assured.") (footnote omitted); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 297 (1975) [hereinafter Posner, *Antitrust Policy*] ("The basic problem is a failure to think about antitrust laws in terms of policy and purpose . . .").

The various commentators are, by no means, in agreement as to *which* policy or policies should be advanced by the antitrust laws. Those of the Chicago School, such as Bork, Posner, and Easterbrook, believe that economic efficiency is the primary, if not sole, goal to be advanced by the Sherman Act. Other commentators argue that, to the contrary, the Supreme Court has swung too far in accomodating the goal of economic efficiency at the cost of story. Equally important, there has been a failure by the Court to analyze carefully another key component of the confusion: the nature of an agreement in the vertical context.[3] Put simply, there has been a pervasive (but erroneous) assumption that the agreement element for a Sherman Act section one *vertical* violation will basically be the same as the agreement element in a *horizontal* offense. In addition, there has been a failure on the Court's part to appreciate that in the vertical area, the definition of "agreement" is intricately related to antitrust policies. Changing one necessarily affects the other.

The Supreme Court's latest forays into the law of vertical restraints—the *Monsanto*[4] and *Business Electronics*[5] opinions—have only muddied the waters further. In these decisions, the Court once again tried unsuccessfully to divorce the vertical agreement from the goals of the law. The result is that these two decisions, insofar as they shed light on vertical restraints, pull in exactly opposite directions: a court simply cannot be faithful to the *Monsanto* holding regarding illegal vertical agreements[6] and *Business Electronics*' statement of the rationale for condemning vertical restraints.[7] Indeed, even standing alone, *Business Electronics* is an enigma. Taken to its logical conclusion, the Supreme Court's decision in this case either wipes out vertical restraints altogether or creates one more in a long line of meaningless distinctions in vertical restraints.

This Article attempts to step back and analyze the agreement component in the Sherman Act section one vertical case.[8] In Part I, the Article explains the pivotal position played by the term "agreement" in a section one violation and how the definition of "agreement" is connected to the goals of the antitrust laws. Parts II and III explore the differences between the horizontal and vertical arrangements and, more specifically, horizontal and vertical agreements. In Part IV, the Article reviews the Supreme Court's vertical restraint decisions, culminating in the recent opinions of *Monsanto* and *Business Electronics.* What.

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sacrificing goals such as dealer freedom. *See infra*, text accompanying notes 21-34 and 60-76. One scholar has recently suggested that the confusion in this area stems from the courts' failure to analyze vertical restraints within the framework of common law property rights as well as in a competition framework. *See*, Peritz, *A Genealogy of Vertical Restraints Doctrine*, 40 HASTINGS L.J. 511, 512 (1989).

3. An early but insightful analysis of the role of the conspiracy element in the Sherman Act section one offense is Professor Turner's article, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962). More recent attempts to explore the agreement component include Anderson, *Vertical Agreements Under Section 1 of the Sherman Act: Results in Search of Reasons*, 37 U. FLA. L. REV. 905, 932-40 (1985) (analyzing concerted activity in terms of profit-maximizing conduct) and Calvani & Berg, *Resale Price Maintenance After* Monsanto*: A Doctrine Still at War with Itself*, 1984 DUKE L.J. 1163. *See also*, VI P. AREEDA, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION, at para. 1442-44 (1986). None of these commentators, however, fully explores how the vertical section one agreement differs from the horizontal section one agreement and the interplay between the agreement in the vertical context and the goals of the Sherman Act.

4. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984).

5. Business Electronics v. Sharp Electronics, 485 U.S. 717 (1988).

6. *Monsanto*, 465 U.S. at 760-64.

7. *Business Electronics*, 485 U.S. at 725-26.

8. There are two types of vertical restraints: (1) those such as tying agreements or full-line forcing which restrict interbrand competition by restricting the dealer's ability to deal with manufacturers of competing brands, and (2) those such as resale price maintenance or territorial or customer restraints which put intrabrand restraints on the dealer by limiting his resale of the manufacturer's product. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 6-7 (1981) [hereinafter Posner, *The Next Step*]. This Article will deal only with vertical arrangements in the second category.

becomes increasingly clear is that, time and time again, the Court has unthinkingly transplanted the language and learning of horizontal agreements into the vertical context, with the result being that the Court's rationale for scrutinizing vertical restraints is now at odds with the law of vertical agreements. Part V of the Article presents a proposal that would allow the Court to continue to follow the economic efficiency rationale (which it seems to prefer) while, at the same time, escape from the logical morass it has created.

II. The Role of Agreement and Antitrust Policy In Shaping Section One Offenses

Analysis of vertical antitrust agreements is, perhaps, best begun by considering two obvious, but easily overlooked, propositions. First, how one defines "agreement" may affect what will be an offense under section one of the Sherman Act.[9] Second, the definition of "agreement" will, itself, be colored by one's view of the goal or goals of the antitrust laws.

A. *Defining "Agreement" Under the Sherman Act*

The Sherman Act section one offense, whether horizontal or vertical,[10] has, in its simplest terms, two central elements. The offense consists of: (1) a contract, combination, or conspiracy—that is, an agreement,[11] (2) to restrain trade—for instance, to fix prices.[12]

The section one offense appears, on its face, to be much like the garden-variety criminal conspiracy offense. Two parties enter into an agreement to commit some act, be it robbery or price fixing. However, the Sherman Act offense differs from the typical criminal conspiracy offense in a significant respect: in the Sherman Act offense the underlying act, restraint of trade, is not unlawful in itself.[13] That is, while it is illegal for a single person, acting alone, to rob a

9. Section one of the Sherman Act, 15 U.S.C. § 1 (1981), provides in relevant part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

10. In the horizontal situation, the agreement is among competitors on the same level. For instance, there may be an agreement among manufacturers to set prices for a product. However, in the vertical context, the agreement is between parties at different levels of the distribution chain, as for example, an agreement between a manufacturer and dealer regarding the resale price of the product. The vertical agreement could also be between a manufacturer and a wholesaler or between a wholesaler and a retailer. For ease of reference, vertical agreements in this Article will be referred to as being between a manufacturer and his dealers.

11. For ease of reference, the term "agreement" will be used throughout this Article to refer to the contract-combination-conspiracy element of the section one offense. While the Sherman Act uses the three terms "contract," "combination," and "conspiracy," it is generally recognized that there is no meaningful distinction among them. *See, e.g.*, VI P. AREEDA, *supra* note 3, para. 1403 at 17-18; J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION § 6.01[1]; Note, *Alliterative Illegalities in Antitrust Law: Contract Combination and Conspiracy*, 15 MEM. ST. U. L. REV. 239, 239 (1985).

12. In addition to these two elements, the section one plaintiff must also prove a connection with interstate commerce, fact of damage, and amount of damage. *See ABA, Sample Jury Instructions In Civil Antitrust Cases*, B-16 to B-17, B-57 (1987). These latter elements, however, are not generally as troublesome as the conspiracy element.

13. Professor Areeda notes: "The Sherman Act is concerned with . . . price fixing only when it is the subject or result of a conspiracy." VI P. AREEDA, *supra* note 3, para. 1402 at 9. Professor Turner has similarly noted: "[C]ondemnation [under section one of the Sherman Act] has depended and continues to depend on finding two

store, it is not unlawful for a single firm, acting alone, to fix prices.[14] Fixing prices is illegal only when there are two parties and an agreement.[15]

Thus, in a section one case, the pivotal determination in judging the legality of the behavior will often be whether an agreement was present.[16] This is true in both the horizontal and the vertical areas, as two simple examples illustrate. Suppose that Manufacturers A, B, C, and D make and market an essentially fungible product. Suppose also that Manufacturer A is the "price leader" in the industry, *i.e.*, Manufacturer A is traditionally the first firm to announce price increases and Manufacturers B, C, and D traditionally follow by adjusting their prices to be the same or about the same as Manufacturer A's price. Each firm has fixed a price. However, whether the firms have violated section one of the Sherman Act depends on whether it can be said that they have agreed, through their practice of price leadership and price following, on a price.[17] Similarly, in the vertical situation, suppose a manufacturer tells his dealer that unless the dealer charges a suggested resale price, the dealer will be terminated,[18] and, suppose further, the dealer charges that price. Again, a price has been fixed. But again, as in the horizontal case, whether there is a section one violation may depend on whether an agreement for antitrust purposes is deemed to

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or more parties who may be said to have 'agreed' to do what was done, since 'agreement' is an essential ingredient of 'contract, combination or conspiracy.'" Turner, *supra* note 3, at 655-56.

14. Section two of the Sherman Act makes some single-firm actions unlawful where the single firm is a monopolist or attempting to be a monopolist. For a historical review of section two see Shores, *Narrowing the Sherman Act Through An Extension of* Colgate*: The* Matsushita *Case*, 55 TENN. L. REV. 261, 261-62 (1988).

There is, thus, a "gap" in the Sherman Act. Section one makes certain concerted action unlawful, and section two makes certain actions by a monopolist (or threatened monopolist) illegal. Left unregulated is single-firm action by a nonmonopolist. In Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 774-75 (1984), the Supreme Court remarked on this gap in the Sherman Act:

> It cannot be denied that § 1's focus on concerted behavior leaves a "gap" in the Act's proscription against unreasonable restraints or trade. . . . Because the Sherman Act does not prohibit unreasonable restraints of trade as such—but only restraints effected by a contract, combination, or conspiracy—it leaves untouched a single firm's anticompetitive conduct (short of threatened monopolization) that may be indistinguishable in economic effect from the conduct of two firms subject to § 1 liability.

See also, Shores, *supra*, at 264-65.

15. By the same token, an acknowledged "agreement" between two firms is, by itself, not a violation of the Sherman Act. Rather, there must be an agreement to take some action that the law considers to be in restraint of trade. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 582-83 (1986); Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 133 (2d Cir.), *cert. denied*, 439 U.S. 946 (1978).

16. Professor Turner has noted, "[T]he definition of agreement has been an important and continuous legal battleground." Turner, *supra* note 3, at 656. *See generally* VI P. AREEDA, *supra* note 3, 1405 at 22. An equally important question, even if an agreement is found, is whether the defendants' actions are "in restraint of trade." *See infra* note 19.

17. Simple price leadership and price following have not traditionally been regarded as concerted action under the Sherman Act. *See*, Sugar Inst. Inc. v. United States, 297 U.S. 553, 560 (1936). However, a lively debate has raged in the literature regarding whether price leadership in an oligopoly market should be restrained under the Sherman Act. *See generally*, R. POSNER, ANTITRUST LAW, *supra* note 1, at ch. 4; Blechman, *Conscious Parallelism, Signalling and Facilitating Devices: The Problem of Tacit Collusion Under the Antitrust Laws*, 24 N.Y.L. SCH. L. REV. 881 (1979); Kestenbaum, *What is "Price Signalling" and Does It Violate the Law?*, 49 ANTITRUST L.J. 911 (1980); Marks, *Can Conspiracy Theory Solve the "Oligopoly Problem"?*, 45 MD. L. REV. 387 (1986); Washburn, *Price Leadership*, 64 VA. L. REV. 691 (1978).

18. For a summary of remedies outside the antitrust laws that may be available to the terminated dealer see Joslyn, *Legislative Definitions of the Franchise Relationship*, 32 N.Y.L. SCH. L. REV. 779 (1987) and White, *The Applicability of Common Law*, 32 N.Y.L. SCH. L. REV. 819 (1987).

be present.[19] As Professor Areeda noted, the task "is to determine which contacts among unrelated persons should be deemed a conspiracy for antitrust purposes, remembering that the only reason to so characterize a relationship is to control or forbid it."[20]

The problem with making the legality and illegality of behavior turn on the presence or absence of an agreement is that the Sherman Act does not define the terms "contract," "combination," or "conspiracy," and thus leaves the concept of an agreement flexible, if not amorphous.[21] For instance, in both of the examples outlined above—horizontal price leadership and vertical price suggestion—one could easily argue that implicit, unspoken agreements in the broad sense of the word were reached between the parties.[22] Yet, in each of these situations, courts have been unwilling to find section one violations precisely because they have been unwilling to find the existence of agreements for antitrust purposes.[23]

B. *Goals of the Sherman Act*

Where the line is drawn between legal and illegal activity under the Sherman Act is necessarily affected by one's views of the goals of antitrust law.[24] What is equally true, but more often overlooked, is that the definition of "agreement" will also be colored by how one assesses the purposes of the laws.[25]

Of late there has been a lively debate in the literature over what is, or should be, the goals of the antitrust laws. (As will be seen in the next sections, the answer to that question is more critical in the vertical area than in the

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19. Price fixing has traditionally been regarded as a "restraint of trade," satisfying the second prong of the section one offense. United States v. Trenton Potteries Co., 273 U.S. 392, 396 (1927); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). One can, however, take the position that, although there has been concerted action, there has not been a restraint of trade because of the circumstances surrounding the fixing of prices and therefore no violation of section one. *See supra* note 12. This, in fact, has been the approach used by the Supreme Court to justify a rule of reason analysis for certain horizontal price fixing and boycott cases where procompetitive benefits flowed from the admittedly concerted activity. *See, e.g.*, Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985); Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979). *See also infra* note 46. In contrast, in the vertical area, the Court has generally relied on a finding of no agreement to justify its conclusion that the Sherman Act has not been violated. *See, e.g.*, United States v. Colgate & Co., 250 U.S. 300, 306-07 (1919). *See generally* Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) and *infra* text accompanying notes 96-250.

20. VI P. AREEDA, *supra* note 3, 1402 at 10.

21. "Agreement" is an equally flexible term in other areas of the law. In contract law, an agreement can be found in the extension of an offer and action by the recipient in conformity with the offer or even in silence by the recipient after receipt of the offer. U.C.C. §§ 2-204(2), 2-206 (1988); 1 CORBIN, CONTRACTS §§ 71, 75 (1963); RESTATEMENT (SECOND) OF CONTRACTS §§ 50, 69 (1981). In criminal law, a mere tacit understanding is enough. There need not be any spoken words of agreement. 1 ANDERSON, WHARTON'S CRIMINAL LAW & PROCEDURE § 83, at 178-79 (1957); W. LAFAVE & A. SCOTT, HANDBOOK ON CRIMINAL LAW §§ 61, at 461 (1972); R. PERKINS & R. BOYCE, CRIMINAL LAW 683-84 (1982).

22. Regarding horizontal price leadership see, R. POSNER, ANTITRUST LAW, *supra* note 1, at ch. 4. Regarding vertical price suggestion situation see, VI P. AREEDA, *supra* note 3, 1442, 1443; Anderson, *supra* note 3, at 937; Turner, *supra* note 3, at 687-88.

23. *See, e.g.*, Sugar Inst. Inc. v. United States, 297 U.S. 553 (1936); United States v. Colgate & Co., 250 U.S. 300 (1919).

24. *See* Posner, *Antitrust Policy*, *supra* note 2 at 282, 297. *See also*, Fox & Sullivan, *Antitrust–Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936 (1987).

25. Similarly, what one views as a restraint of trade is inevitably colored by how one defines the goals of the Sherman Act. *See supra* note 19.

horizontal area.) On one side are the adherents to what has been called the Chicago School of antitrust analysis, or the economic efficiency model.[26] They argue that the sole goal of the antitrust laws is, or should be, economic efficiency.[27] That is, the antitrust laws should prohibit competing firms from banding together in a horizontal cartel to restrict output and thereby raise prices.[28]

In the opposing camp are the "traditionalist" scholars[29] who contend that while economic efficiency may be a goal of the laws, it is just one of a number of goals that the antitrust laws were intended to foster.[30] This group contends that goals such as dealer freedom (the right of each merchant to make his or her own marketing decisions) and dispersion of power among many merchants are equally important.[31]

A simple example illustrates how the choice of goals can affect the contours of an agreement for antitrust purposes. Reconsider the dealer who grudgingly goes along with the manufacturer's suggested resale prices to avoid termination. Is there an agreement between the manufacturer and dealer regarding prices and therefore a violation of the Sherman Act?[32] The arrangement no

26. For a brief history of the Chicago School's antitrust analysis and a summary of the key aspects of the Chicago approach see Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979) [hereinafter Posner, *The Chicago School*].

27. *See* R. BORK, *supra* note 1, at 20-21; R. POSNER, ANTITRUST LAW, *supra* note 1, at 19-20; Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 138-40 (1984) [hereinafter Easterbrook, *Vertical Arrangements*]; Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 TEX. L. REV. 705, 715-16 (1982) [hereinafter Easterbrook, *Is There a Ratchet*]. Posner and Easterbrook argue that even if Congress wanted to promote small business or protect a dealer's freedom to make his own marketing decisions, the antitrust laws are not good vehicles for furthering these goals. Easterbrook, *Is There a Ratchet, supra*, at 715-16; R. POSNER, ANTITRUST LAW, *supra* note 1, at 19.

28. The theory is based on simple economic principles. If firms in an industry act independently, industry-wide prices will eventually be lowered to a competitive price and output will expand to meet consumer demand. Conversely, if competing firms act in concert and reduce output, the result will be monopoly prices and a misallocation of society's resources. R. BORK, *supra* note 1, at 90-106; Easterbrook, *Vertical Arrangements, supra* note 27, at 140.

29. The label "traditionalist" is taken from Fox & Sullivan, *supra* note 24, at 957. The traditionalists also contend that the Chicago School approach results in faulty jurisprudence. The economic efficiency model, they argue, substitutes predetermined rules, assumptions and rigid deductive reasoning for the traditional complex fact determination and inductive reasoning that is proper in legal analysis. *See, e.g.*, Flynn & Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. REV. 1125, 1130-36 (1987). *See also* Flynn, *The "is" and "ought" of Vertical Restraints After* Monsanto Co. v. Spray-Rite Serv. Corp., 71 CORNELL L. REV. 1095, 1124-31 (1986).

30. *See, e.g.*, Flynn, *supra* note 29 at 1137-39; Flynn & Ponsoldt, *supra* note 29 at 1138; Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1146-54 (1981).

31. Professor Fox contends that Congress had four major goals in mind when it enacted the antitrust laws: "(1) dispersion of economic power, (2) freedom and opportunity to compete on the merits, (3) satisfaction of consumers, and (4) protection of the competition process as market governor." Fox, *supra* note 29, at 1182; *also quoted in* Flynn, *supra* note 29, at 1138-39 and Flynn & Ponsoldt, *supra* note 30, at 1138.

32. There are, in the vertical area, a myriad of possible interactions between the manufacturer and the dealer. The manufacturer and dealer may have an express agreement regarding resale prices: the manufacturer may simply suggest prices and refuse to deal with those who will not charge those prices; the dealer may announce his willing compliance with manufacturer-suggested prices; the dealer may grudgingly announce that he will go along with the manufacturer-suggested prices; there may be a long pattern of sales to the dealer in conjunction with the dealer's acquiescence in the manufacturer-suggested prices and a pattern of terminations when such prices are not followed. As commentators have noted, courts face an almost impossible task in trying to decide which of these arrangements constitutes an "agreement" and which do not. *See, e.g.*, VII P. AREEDA, *supra* note 3, 1442, 1443; Liebeler, *Intrabrand "Cartels" Under* GTE Sylvania, 30 UCLA L. REV. 1, 9-10 (1982); Turner, *supra* note 3, at 688, 692.

doubt deprives the dealer of some of his freedom to price the product. If a purpose of the antitrust laws is to protect such freedom, then one might find that an agreement has been formed and section one has been violated.[33] On the other hand, if the sole purpose of the law is to prohibit the economic inefficiency flowing from horizontal cartels, then there is no point in finding the arrangement to be an antitrust "agreement" and therefore violative of the law.[34] Put simply, many situations can be interpreted as either an "agreement" or "unilateral action,"[35] depending on whether one wants to prohibit or control the underlying activity.[36]

III. The Horizontal Arrangement: An Easy "Fit" With Antitrust Goals and Traditional Conspiracy Theory

The garden-variety horizontal arrangement—where competing manufacturers of a fungible product agree among themselves to fix a price for their product or to divide territories or customers — has proven to be relatively easy to analyze.[37] This is, in large part, because the horizontal arrangement is an easy "fit" with the various goals of the antitrust laws and because the agreement element in the horizontal arrangement is conceptually similar to the familiar criminal conspiracy offense.

First, the garden-variety horizontal arrangement poses little or no problem in choosing among the competing goals of the antitrust laws. It fails the economic efficiency test of the Chicago School because it permits otherwise competitive firms to combine their individual market power and to act, in essence, as a monopoly, with a monopolistic price and restricted output.[38] In addition, the horizontal arrangement takes away the individual freedom of each partici-

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33. *See, e.g.*, Albrecht v. Herald Co., 390 U.S. 145, 150, 152 (1968).

34. Alternatively, one could argue that although an agreement is present, there is no restraint of trade. *See supra* note 19 and *infra* text accompanying notes 215-18. Advocates of the Chicago School, however, generally take the position that there is no agreement when a manufacturer imposes vertical restraints; such a manufacturer acts unilaterally. *See generally* Easterbrook, *Vertical Arrangements*, *supra* note 27, at 146-49; Posner, *Antitrust Policy*, *supra* note 2, at 284-85; Posner, *The Next Step*, *supra* note 8, at 11-12.

35. It is not just the ambiguous situation that is open to interpretation. Whether to subject explicit contracts to section one scrutiny also turns on one's views of the purpose of the Sherman Act. *See infra* text accompanying notes 144-254.

36. VI P. Areeda, *supra* note 3, 1402, at 10; Posner, *The Next Step*, *supra* note 8, at 11-12.

37. I am assuming, in the "garden-variety" horizontal agreement, that the participants in the arrangement are manufacturers or suppliers of different brands. In other words, I am assuming a restraint on interbrand competition. While dealers handling the same brand of merchandise could conceivably band together to fix prices, such an intrabrand restraint has a different effect than the interbrand restraint. An intrabrand restraint, although horizontal, does not restrict output in the larger interbrand market and, therefore, is not likely to reduce market efficiency. *See* H. Hovenkamp, Economics and Federal Antitrust Law § 9.2, at 249-50 (1985); Liebeler, *supra* note 32, at 14-19.

38. The more market power the conspiracy firms have, the more closely they will mimic a monopolist. The proponents of the Chicago School, therefore, have no problem condemning a conspiracy where the members have significant market power. *See, e.g.*, H. Hovenkamp, *supra* note 37, § 4.1, at 83; Posner, *The Chicago School*, *supra* note 26, at 960.

At the same time, some commentators argue that because of the inevitable cheating by the conspirators (*see infra* note 43) and likely new entrants into the market, the horizontal conspiracy contains the seeds of its own destruction and will, even if left alone, eventually break up. H. Hovenkamp, *supra* note 37, § 4.1, at 83-91; R. Posner, Antitrust Law, *supra* note 1, at 28. Professor Posner further argues that where the conspiring firms collectively lack market power, the conspiracy should not be condemned, because, lacking market power, the firms pating firm to make its own marketing decisions and results in a concentration, as opposed to dispersion, of power.[39] Thus, regardless of which antitrust goal one views as paramount, the horizontal arrangement among competitors will most likely be condemned.[40]

Furthermore, the agreement element in a horizontal arrangement is easy to understand because it is conceptually quite similar to the typical criminal conspiracy. Just as two conspiring bank robbers act together for their common good, *i.e.*, to bring off a heist, so too, in a horizontal price fixing arrangement, two or more firms work together under a common plan to raise prices. All participating firms, like the conspiring robbers, benefit when the plan succeeds.[41] (Of course, society does not benefit from bank robberies or price fixing.) Thus, there is a plan that is truly common to all participants,[42] a unity of purpose, and mutual understanding that each will act in accordance with the plan.[43] Furthermore, in the horizontal arrangement, like the criminal conspiracy, a finding of an *explicit* agreement, while not required,[44] obviously satisfies the agreement element of the offense.[45]

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cannot restrict output in the industry. Posner, *Antitrust Policy*, *supra* note 2, at 298-99. *Contra*, L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 192 (1977).

39. *See* Fox, *supra* note 30, at 1183. *See also* E.T. SULLIVAN & J. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 71-75 (1988).

40. The one goal that is arguably not furthered by condemning horizontal agreements is the goal of protecting small businesses. A group of small businesses could conceivably argue that they need to combine to fix prices in order to be competitive with other, more efficient, firms in the industry. *See, e.g.*, Appalachian Coals, Inc. v United States, 288 U.S. 344 (1933). If one believes that protecting small businesses, even inefficient ones, is a goal of the antitrust laws, then one might not want to condemn such a horizontal price fixing conspiracy.

41. Professor Anderson has expressed this in terms of "profit-maximizing" behavior that depends on the actions of the other conspirators:

> In choosing to forego the profits available by beating the cartel price, cartel members are opting instead for the profits derived from the continuing operation of the cartel. The profit maximizing nature of this action depends upon other members of the cartel restricting their output and maintaining the cartel price.

Anderson, *supra* note 3, at 931.

42. The horizontal plan will, in fact, only work because of the joint action. Again, this is simple economics. Assuming there is a competitive market, if one firm alone raises its prices, it will lose sales and revenues. Only when all (or a significant number) of the firms act in unison and raise prices will the action be effective. *See* H. HOVENKAMP, *supra* note 37, at 83-91; L. SULLIVAN, *supra* note 38, at 162-63.

43. Each member of the price-fixing conspiracy will, of course, also have a strong motive to cheat on the cartel. If a member can secretly make sales at a price below the cartel price, that member will be able to increase his profits by increasing his units sold. *See* H. HOVENKAMP, *supra* note 37, at 83-88; R. POSNER, ANTITRUST LAW, *supra* note 1, at 51-55. This, however, is no different from the conspiring thieves, each of whom will be better off if he can get a larger share of the loot.

44. *See, e.g.*, United States v. General Motors Co., 384 U.S. 127, 142-43 (1966); American Tobacco Co. v. United States, 328 U.S. 781, 809 (1946).

45. *See, e.g.*, United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897). The more difficult case, in the horizontal situation, is the conscious parallelism situation, *i.e.*, the case in which a number of competitors knowingly act in the same way, but without an express agreement to do so. Reasoning that consciously parallel action may be the result of independent unilateral action, the Supreme Court held in Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939), that conscious parallelism alone is not proof of an agreement among competitors. (However, the Court held it is proof of an unlawful conspiracy.) In addition to conscious parallelism, the antitrust plaintiff must show evidence of one or more "plus factors" from which the trier of fact can infer an agreement. *Id. See generally* E.T. SULLIVAN & J. HARRISON, *supra* note 38, at 125; J. VON KALINOWSKI, supra note 11, at § 6.01[3][a]; Note, *Conscious Parallelism: The Business Judgment Defense in a Summary Judgment Context*, 35 HASTINGS L.J. 115, 121-24 (1983).

Because there is rarely a procompetitive reason for competitors to coordinate their pricing or other key marketing activities,[46] the illegal horizontal arrangement is also relatively easy to identify. Put another way, except in certain limited situations, there is generally no such thing as a legal multifirm horizontal arrangement to fix prices or to divide territories or customers.[47] Just as there is no need to distinguish between legal and illegal two-party arrangements to rob banks, so too, the law does not, absent some ancillary procompetitive effect of the arrangement, need to distinguish between legal and illegal two-party horizontal arrangements to fix prices or to divide territories or customers. All of these arrangements are illegal.[48]

Not surprisingly, the horizontal price-fixing cases developed quickly and without too much difficulty.[49] As early as 1898, the Supreme Court held that horizontal price-fixing agreements were illegal regardless of the reasonableness of the price fixed.[50] By 1927, the Court had concluded that horizontal price fixing was sufficiently harmful to be categorized as per se illegal.[51] Apart from certain limited cases where the price restraint facilitates competition,[52] the rule remains the same today.[53] In reaching this result, the Supreme Court has typically concluded—without parsing through the various goals of the antitrust laws—that horizontal price fixing is "the archetypical example" of a "plainly anticompetitive" practice.[54]

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46. Occasionally, competitors can show a procompetitive reason for coordinating their pricing or other marketing activity. In such a case, the Supreme Court has held that the concerted activity should be judged under the rule of reason rather than under the per se rule. *See* NCAA v. Board of Regents, 468 U.S. 85 (1984); Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979). *See also* Wirtz, *Rethinking Price-Fixing*, 20 IND. L. REV. 591 (1987) (discussing when a case falls into the rule of reason exception for horizontal restraints). In so holding, the Supreme Court has not said that such restraints are legal or that the agreement element of the section one case is lacking. Rather, the Court has held that determination of whether the admittedly-concerted activity unreasonably restrains trade requires a fuller rule of reason analysis.

47. Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982); United States v. Trenton Potteries Co., 273 U.S. 392, 396-402 (1927).

48. Posner argues that the Supreme Court should further refine its application of the per se rule for horizontal restraints and apply it only when the conspiracy firms collectively have market power. Posner, *Antitrust Policy*, *supra* note 2, at 298-99.

49. The difficulty in the early horizontal price-fixing cases centered on whether such a restraint should be judged under the rule of reason or a per se analysis. In Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918), the Court used a rule of reason approach. By 1927, however, the Court had settled upon a per se analysis for the garden-variety case of horizontal price-fixing, *Trenton Potteries*, 273 U.S. at 396-401. Even today, what debate there is regarding horizontal price-fixing centers on whether the per se rule, or a rule of reason methodology, should apply. To date, the rule of reason approach has been used only when the restraint promotes or facilitates competition. *See supra* note 46. *See generally* Allison, *Ambiguous Price Fixing and the Sherman Act: Simplistic Labels or Unavoidable Analysis?*, 16 HOUST. L. REV. 761 (1979).

50. United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).

51. *Trenton Potteries*, 273 U.S. at 396-401. Horizontal territorial divisions were similarly held to be per se illegal. United States v. Topco Assocs., Inc., 405 U.S. 596, 606-12 (1972); United States v. Sealy, Inc., 388 U.S. 350 (1967).

52. *See supra* note 47.

53. Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982); Catalano Inc. v. Target Sales, Inc., 446 U.S. 643 (1980). *See also*, Wirtz, *supra* note 46, at 596.

54. *Target Sales*, 446 U.S. at 646-47. *See also* NCAA v. Board of Regents, 468 U.S. 85, 100 (1984) ("Horizontal price fixing and output limitation are ordinarily condemned as a matter of law under an 'illegal *per se*' approach because the probability that these practices are anticompetitive is so high."); United States v. Topco Assocs., Inc., 405 U.S. 596, 608 (1972) ("This Court has reiterated time and time again that '[h]orizontal territo-

IV. THE VERTICAL ARRANGEMENT: A DIFFERENT TYPE OF BEAST

The vertical arrangement is, quite simply, a different type of beast than the horizontal arrangement. Indeed, the vertical and horizontal arrangements differ in four key ways.

A. *The Number of Necessary Players in a Legal Arrangement*

A fundamental difference between the horizontal and vertical arrangements is that, in a simplified sense, any two-party horizontal arrangement is legally suspect, whereas by definition, two-party vertical arrangements are typically legal. As explained, except in certain limited circumstances,[55] there is generally no legitimate reason for firms to cooperate on a horizontal basis with respect to prices, customers, or territories.[56] Each firm can, by and large, make its own marketing decisions independent of its competitors.[57]

Conversely, in the vertical area allowance must be made for legal two-party arrangements. By definition, vertical distribution requires two parties on different levels of marketing. Unless courts wish to take a Draconian approach and require that every manufacturer do his own retailing, courts must admit that there are legal (and not even challengeable) two-party vertical arrangements. Put another way, in the vertical context, there is always a procompetitive justification for cooperation between two otherwise independent parties: they wish to market a product and doing so requires two parties. Inevitably, there are going to be contracts and agreements involved in such marketing arrangements, whether they are written franchising contracts or implicit understandings of how the parties expect to do business. And because it always takes "two to tango" in vertical distributions, there is the problem of distinguishing between the legal and the illegal vertical arrangement under antitrust law.[58] To use a sexy analogy, it is like distinguishing between legal marital sex and illegal adultery. Both acts involve two parties engaging in sexual relations, but only adultery is illegal in some states.[59] So too, as long as manufacturers are permit-

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rial limitations . . . are naked restraints of trade with no purpose except stifling of competition.' ") (quoting White Motor Co. v. United States, 372 U.S. 253, 263 (1976)).

55. In certain limited situations, a horizontal cooperative arrangement may promote or facilitate competition. However, even in these situations the arrangement is not automatically legal but, rather, its legality is determined under the rule of reason. *See supra* note 46.

56. *See supra* notes 37-54 and accompanying text.

57. Indeed, one premise of the pure competition economic model is that each firm makes its own marketing decisions. The model assumes that the competitive firm knows what its competitors are charging for the product and takes that information into account in setting its own price, but that there is no agreement among competing firms on prices. H. HOVENKAMP, *supra* note 37, § 1.1, at 1-2; E.T. SULLIVAN & J. HARRISON, *supra* note 39, at 10.

58. One way of eliminating this problem is to take the position that all vertical arrangements should be presumptively or even per se legal. R. BORK, *supra* note 1, at 288; H. HOVENKAMP, *supra* note 37, at 135; Baxter, *supra* note 1, at 947; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 135; Piraino, *The Case for Presuming the Legality of Quality Motivated Restrictions on Distribution*, 63 NOTRE DAME L. REV. 1, 19 (1988); Posner, *The Next Step*, *supra* note 8, at 23.

59. *See, e.g.*, ALA. CODE § 13A-13-2 (1975); IDAHO CODE § 18-6601 (1987); ILL. ANN. STAT. ch. 38, para. 11-7 (Smith-Hurd 1979); MICH. COMP. LAWS ANN. §§ 750.29, 750.30 (West 1968); MINN. STAT. ANN. § 609.36 (West 1987); N.Y. PENAL LAW § 255.17 (McKinney 1989).

ted to distribute their products through independent dealers, a distinction must be made between legal and illegal two-party vertical arrangements. Unlike the horizontal arrangement, it simply cannot be assumed that any arrangement involving two independent firms is inherently suspect.

B. *The Effect on Market Power*

Horizontal and vertical arrangements also differ in their effect on market power. In the horizontal arrangement, there is a combination of otherwise competing firms and, with it, a combination of the agreeing firms' market power.[60] In the vertical arrangement, by contrast, the cooperative arrangement does not lead to an increase in market power. The manufacturer of widgets who contracts with a dealer to market his product does not thereby increase his market power in the widget market—even if the manufacturer engages in blatant resale price maintenance.[61]

C. *The "Fit" With the Goals of the Antitrust Laws*

The third distinction between horizontal and vertical arrangements flows inevitably from the second. As previously noted, the horizontal arrangement—which increases the market power of the participating firms—easily fits the various profferred goals of the antitrust laws.[62] It is economically inefficient, diminishes the merchants' freedom, and concentrates power. The vertical arrangement, on the other hand, does not increase the manufacturer's market power and is not so clearly economically inefficient.

Indeed, the Chicagoans and other proponents of the economic efficiency model, whose views have gained increasing acceptance by the Supreme Court,[63] strenuously argue that vertical restraints, while limiting intrabrand competition,[64] actually promote interbrand competition and are, therefore, economically efficient.[65] They note that a manufacturer would not impose any vertical restraints and thereby increase his distribution costs[66] unless those restraints,

60. L. SULLIVAN, *supra* note 38, at 162. The increase in market power harms society in that it permits the combining firms to mimic a monopolist. *See supra* note 38.

61. VII P. AREEDA, *supra* note 3, para. 1437, at 4; R. BORK, *supra* note 1, at 289-90; Comanor, *Vertical Arrangements and Antitrust Analysis*, 62 N.Y.U. L. REV. 1153, 1153-54 (1987); Posner, *The Chicago School, supra* note 26, 928.

62. *See supra* notes 37-54 and accompanying text.

63. *See infra* notes 126-88 and accompanying text.

64. Some commentators argue that vertical restraints do not restrict intrabrand competition in an economic sense because there is no restriction of output even in the intrabrand market. *See, e.g.*, Liebeler, *supra* note 32, at 14-19; H. HOVENKAMP, *supra* note 37, § 9.4, at 268-69.

65. *See, e.g.*, H. HOVENKAMP, *supra* note 37, at 252-54; Baxter, *supra* note 1, at 945-46; Easterbrook, *Vertical Arrangements, supra* note 27, at 146-49; Hay, *supra* note 2, at 437; Posner, *The Next Step, supra* note 8, at 22-23.

66. "The difference between the price at which the manufacturer sells to the dealer and the dealer's price to consumers is the manufacturer's cost of distribution. . . ." R. POSNER, ANTITRUST LAW, *supra* note 1, at 147. A manufacturer, like any seller, wants to reduce this cost. By imposing a vertical restraint, such as resale price maintenance, the manufacturer raises the dealer's price to the consumer and reduces the consumer demand for the product. *Id. See* Easterbrook, *Vertical Arrangements, supra* note 27, at 146-47.

whether they are price, customer, or territorial restraints,[67] made his product more attractive to consumers[68] and consequently increased his competitive position among similar manufacturers.[69] Specifically, the manufacturer uses vertical restraints such as resale price maintenance, not to enable the dealer to obtain monopoly profits, but rather to entice the dealer into providing services to the consumer.[70] The manufacturer, in other words, uses vertical restraints as a way of offering the consumer a "package" of product plus service which, although more costly than the product alone,[71] the manufacturer believes will enhance its

67. Adherents to the economic efficiency model argue that all vertical restraints—price and nonprice—function in the same way, and all should be treated in the same way under the antitrust laws. H. HOVENKAMP, *supra* note 37, at 261-62; R. POSNER, ANTITRUST LAW, *supra* note 1, at 160; Liebeler, *supra* note 32, at 46-47; Piraino, *supra* note 58, at 15, 26; Posner, *The Next Step*, *supra* note 8, at 9-11.

68. Under this theory, vertical restraints such as resale price maintenance are output enhancing. The manufacturer believes that the quantity of his product sold will increase (even though each unit is more costly to the consumer) because of the added services provided by the dealer. If this were not the case, the manufacturer would not impose the vertical restraint on his dealers. Calvani & Berg, *supra* note 3, at 1182. If the manufacturer is wrong about consumer demand for the services added to the product, sales will fall off and the manufacturer will make adjustments. *Id.*; Baxter, *supra* note 1, at 945-46. *See also* H. HOVENKAMP, *supra* note 37, at 254.

69. The Chicago School view rests, at bottom, on the assumption that the manufacturer is a rational business person. This assumption is, of course, open to question. Nobel-prize winning novelist Saul Bellow (who is coincidentally a faculty member at the University of Chicago) describes the following exchange that supposedly took place with Chicago economist Milton Friedman:

> Somebody asks [Friedman], 'Are you sure that Economic Man *is* completely rational—can we depend on it? Many qualified thinkers have asserted that the behavior of *Homo sapiens* is distinctly paranoid. . . . Now, how does this incontrovertible insanity square with your theory of Economic Man?' Friedman answers that no matter how crazy people are, they still remain sane about money. . . . All he seems to say is that between humankind and full chaos there stands only the free market.

S. BELLOW, MORE DIE OF HEARTBREAK 144 (1987).

70. The dealer-service theory says that when the manufacturer fixes a resale price that exceeds costs (or assigns exclusive territories to his dealers), the dealers will step up nonprice competition among themselves. That is, the dealers will provide services to the consumer. (Because the consumer will pay the same price for the product, wherever she goes, the consumer will naturally go to the dealer who is providing the greatest services.) The dealer will continue providing such services, according to this theory, until his marginal cost of distribution has risen to meet the resale price. At this point, the dealer is not receiving any monopoly profits; he is, however, furnishing services at the level desired by the manufacturer. R. POSNER, ANTITRUST LAW, *supra* note 1, at 148; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 147-48. *See* H. HOVENKAMP, *supra* note 37, at 249.

Adherents to the Chicago School include in the "services" provided by the dealer matters such as advertising, inventory, showrooms, display, and knowledgeable sales personnel. Posner, *The Chicago School*, *supra* note 26, at 926-27. Some commentators argue that dealer "services" must also include display and "certification" of a product by "upscale" dealers. Calvani & Berg, *supra* note 3, at 1186-87; Popofsky & Bomse, *supra* note 2, at 91-92; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 150. Consumers, it is argued, must want these services, including advertising, or they would not pay for them. Baxter, *supra* note 1, at 946; Piraino, *supra* note 58, at 19-23; Posner, *The Chicago School*, *supra* note 26, at 930.

Other commentators, while agreeing with much of the dealer-service theory of resale price maintenance, take issue with the Chicago School view that all of the dealer-provided services are desired by all or most consumers. *See, e.g.*, Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 990-92 (1985); Hovenkamp, *Fact, Value and Theory in Antitrust Adjudication*, 1987 DUKE L.J. 897, 909-11; Levmore, *Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information*, 67 IOWA L. REV. 981, 986-90 (1982); Weiss, *The Dealer-Services Rationale for Resale Price Maintenance: Does the Manufacturer* Really *Know Best?*, 30 ST. LOUIS U. L.J. 517, 526-31 (1986).

71. Instead of imposing resale prices, a manufacturer could theoretically achieve the same result by allowing the dealer full freedom to price the product but, at the same time, requiring the dealer to provide certain specified services. L. SULLIVAN, *supra* note 38, at 386. The Chicagoans respond, however, that for certain products resale price maintenance is an easier and cheaper way for the manufacturer to ensure that his dealers will provide the services. H. HOVENKAMP, *supra* note 37, § 9.2, at 255-57; Posner, *Antitrust Policy*, *supra* note 2, at 294; Posner, *The Next Step*, *supra* note 8, at 20.

position with consumers in the interbrand market.[72] The Chicagoans argue that this results in manufacturer-imposed vertical restraints that actually increase, rather than decrease, economic efficiency.[73]

Assuming all of this to be true, the vertical arrangement does, nonetheless, frequently offend the other goals of the antitrust laws. In particular, when the manufacturer imposes restraints on the dealer, the dealer's freedom of choice is diminished if not eliminated.[74] Thus, unlike the horizontal arrangement, the vertical arrangement forces courts to choose between the competing goals of the antitrust laws. To the extent one believes that economic efficiency is, or should be, the predominant goal of antitrust law, one will be slow to condemn vertical arrangements.[75] On the other hand, to the extent one sees dealer freedom as a significant and serious goal of the Sherman Act, one will be more willing to categorize vertical arrangements as illegal under either a per se rule or a rule of reason approach.[76]

D. *The "Fit" With Traditional Conspiracy Law*

Finally, the vertical arrangement does not "fit" the traditional conspiracy model as easily as the horizontal arrangement. In a horizontal agreement, the participating firms join together with a common plan for their (although not society's) common benefit; all participants benefit, in the form of excess profits, when the plan succeeds;[77] and because each firm will recognize that it is in its interest to join the conspiracy, the plan is not typically "forced" on any participant.[78] In a vertical agreement, by contrast, there is not necessarily a "meeting

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72. Under this dealer-service theory, the manufacturer cannot simply lower his price to dealers and hope that they will supply the desired services. Even if some dealers do provide the services, other dealers will inevitably get a "free ride." Those dealers who supply the services will necessarily have to charge a higher price. The free-riding dealer charges a lower price to consumers and provides no services; he rides on the services provided by other dealers. The full-service dealers will eventually lose customers and go out of business, to the detriment of the manufacturer (who has lost distribution) and to the detriment of the consumer (who wants the services). To avoid the free-rider problem, the manufacturer will impose his vertical restraints on all his dealers. When all dealers have, for instance, the same resale price, the consumer has no incentive to go to the no-service dealer. Instead, to attract customers, all dealers will compete on nonprice aspects of the sale, such as service. H. HOVENKAMP, *supra* note 37, § 9.2, at 252-53; R. POSNER, ANTITRUST LAW, *supra* note 1, at 149; Calvani & Berg, *supra* note 3, at 1181-82; Kelly, *The Role of the Free Rider In Resale Price Maintenance: The Loch Ness Monster of Antitrust Captured*, 10 GEO. MASON U.L. REV. 327 (1988); Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 91-92 (1960).

73. Adherents to the Chicago School distinguish between manufacturer-imposed vertical restraints (which, they contend, are procompetitive) and vertical restraints that are the result of a dealer cartel (which, they admit, are likely anticompetitive). R. POSNER, ANTITRUST LAW, *supra* note 1, at 148-51; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 141-42; Posner, *The Next Step*, *supra* note 8, at 22-25. *See also infra* notes 91 and 92.

74. L. SULLIVAN, *supra* note 38, at 376-77; Flynn, *supra* note 29, at 1144.

75. Some adherents of the Chicago School have, thus, argued that all vertical restraints should be presumptively, or even per se, legal. *See supra* note 58.

76. *See, e.g.*, L. SULLIVAN, *supra* note 38, at 376-77; Flynn, *The Function and Dysfunction of Per Se Rules in Vertical Market Restraints*, 58 WASH. U.L.Q. 767, 786-90 (1980) [hereinafter Flynn, *The Function and Dysfunction*]; Flynn, *supra* note 29, at 1114-45.

77. *See supra* notes 37-54 and accompanying text. Having joined the horizontal conspiracy, the participant will, however, have a motive to cheat on the cartel. *See supra* note 43.

78. Conceivably, a price-fixing cartel could coerce a competitor (through threats of predatory pricing) to join their horizontal cartel. Duplan Corp. v. Deering Milliken, 594 F.2d 979, 982 (4th Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980); VI P. AREEDA, *supra* note 3, para. 1408c, at 46-47. Such cases, however, are likely to be rare.

of the minds" or "unity of purpose" to carry out a common plan that is regarded by both manufacturer and dealer to be in their common good. This is true, regardless of whether one accepts the Chicago School's economic efficiency approach or the traditionalist view of vertical restraints.

Under the Chicago School's economic efficiency approach, the imposition of vertical restraints is seen as a decision resting principally and ultimately with the manufacturer rather than a "joint" manufacturer-dealer endeavor.[79] The manufacturer imposes vertical restraints not to benefit his dealer but because he believes a package of product plus service will increase his competitive position and profit in the interbrand market.[80] While the manufacturer will naturally want his dealer to prosper, he will also want to limit his dealer to merely a competitive rate of return.[81]

The dealer faced with manufacturer-imposed vertical restraints will not, under this theory, necessarily share a unity of purpose with the manufacturer towards the restraints. To the contrary, the dealer may, depending on the circumstances, be pleased, indifferent, or opposed to the restraints. The dealer will favor the restraints if the dealer believes that sales will increase through a package of product plus service.[82] A dealer will, however, presumably be indifferent if he believes that the number of units sold will stay the same regardless of the added services.[83] Furthermore, the dealer will oppose the restraints (as dealers generally do in the litigated cases)[84] if he believes that the manufacturer is wrong in his assumption that consumers want and will pay for service in addition to the product. (The dealer will also oppose the vertical restrictions, at least insofar as they apply to him, if he wants to "free ride" on other dealers.)[85] The manufacturer may be interested in his dealer's views on the consumer demand

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79. *See, e.g.*, Hay, *supra* note 2, at 422. *See generally* H. HOVENKAMP, *supra* note 37, § 9.2, at 252; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 146-48; Posner, *The Next Step*, *supra* note 8, at 11-12.

80. *See supra* notes 62-74 and accompanying text. Conceivably, a manufacturer and dealer could join forces to charge an above-competition price to an unsuspecting customer and split the extra profits. *See, e.g.*, DeLong Equip. Co. v. Washington Mills Abrasive Co., 887 F.2d 1499 (11th Cir. 1989). Such a scheme would be relatively short-lived and end when the customer realized that he was being overcharged.

81. The dealer's rate of return is part of the cost of distribution for the manufacturer. To the extent that the dealer can extract greater profits from the distribution of a product, he does so at the detriment of the manufacturer. R. POSNER, ANTITRUST LAW, *supra* note 1, at 152-53. *See* H. HOVENKAMP, *supra* note 37, at 249; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 146-47. *See also* R. BORK, *supra* note 1, at 290 ("No manufacturer . . . will ever use . . . resale price maintenance . . . for the purpose of giving the resellers a greater-than-competitive return."). Indeed, adherents to the Chicago School argue that the manufacturer and consumer are both best served when the dealer is limited to a competitive rate of return. Baxter, *supra* note 1, at 946; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 146-47.

82. The dealer in such a situation benefits not by getting monopoly profits but by selling more units (with a competitive rate of return on each unit). H. HOVENKAMP, *supra* note 37, § 9.2, at 249; R. POSNER, ANTITRUST LAW, *supra* note 1, at 157; Liebeler, *supra* note 32, at 25.

83. The dealer here will be getting a higher resale price for the package of product plus service, but the higher price will simply pay for the services he is providing. His rate of return will remain at a competitive level. *See supra* note 71. Therefore, if the dealer is selling the same number of units (at a competitive return) with or without the services, he will likely be indifferent to whether the services are included in the product package.

84. *See, e.g.*, Business Electronics v. Sharp Electronics, 485 U.S. 717 (1988); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). The Chicagoans would argue that the complaining dealers are, more often than not, would-be free riders. *See also supra* note 73.

85. *See supra* note 72.

for extra services,[86] yet in the final analysis the decision on vertical restraints will be the manufacturer's. If the manufacturer believes the restraints to be in his self-interest, he will impose them even if his dealers do not agree that the restraints are also in their common good and only grudgingly comply.[87]

With respect to the "agreement" element of the vertical arrangement, the picture painted by the traditionalists is not all that different. They agree that the manufacturer acts in his own self-interest in imposing vertical restraints but argue that typically such restraints are not in the dealers' or society's interest,[88] are often thrust upon unwilling dealers, and diminish the dealers' freedom of choice.[89] Thus, the traditionalists are even less likely than the Chicagoans to find a meeting of the minds or a common plan in typical manufacturer-imposed vertical restraints.

The Chicagoans and the traditionalists both agree that there are two other anticompetitive scenerios[90] that can account for the imposition of vertical restraints: (1) a manufacturer cartel and (2) a dealer cartel.[91] However, neither of these scenarios fits the traditional concept of conspiracy. In the case of a manufacturer cartel, the manufacturers of competing brands use vertical restraints as a means of policing their cartel.[92] In such a situation, however, the manufacturers reap the monopoly profits. The dealers can, therefore, be expected to resist the restraints.[93] In the case of a dealer cartel, where the dealers use the vertical restraints to police their cartel,[94] the monopoly profits go to the dealers. The manufacturers, who receive no benefit, can be expected to resist.[95]

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86. *See* R. POSNER, ANTITRUST LAW, *supra* note 1, at 157; Baker, *supra* note 1, at 1506. *See also, Monsanto*, 465 U.S. at 762-63.

87. The manufacturer, under this theory, has the best sense of interbrand competition. If the manufacturer is wrong about the consumer's desire for the added services, he will find out when his sales drop off and will make adjustments accordingly. Shores, *Vertical Price Fixing, and the Contract Conundrum: Beyond* Monsanto, 54 FORDHAM L. REV. 377, 401 (1986). *See* R. POSNER, ANTITRUST LAW, *supra* note 1, at 157; Hay, *supra* note 2, at 438; Piraino, *supra* note 58, at 25.

88. *See, e.g.*, Flynn, *supra* note 29, at 1144; Weiss, *supra* note 70. Thus, while scholars generally agree that the manufacturer imposing vertical restraints acts in his own perceived self-interest, they disagree over whether consumers are benefitted by manufacturer-imposed vertical restraints.

89. *See, e.g.*, Flynn, *supra* note 29, at 1144. *See generally* L. SULLIVAN, *supra* note 38, at 376-77; Flynn, *The Function and Dysfunction*, *supra* note 76, at 789.

90. Both the manufacturer and dealer cartels are anticompetitive because they are simply horizontal arrangements permitting would-be competitors to pool their individual market power and, thereby mimic a monopolist. *See supra* note 38 and accompanying text.

91. While Chicago School adherents agree that such cartels can result in vertical restraints, they argue that such cartels are rare. *See, e.g.*, H. HOVENKAMP, *supra* note 37, § 9.2, at 250-52; R. POSNER, ANTITRUST LAW, *supra* note 1, at 148-53; Baxter, *supra* note 1, at 941-45; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 141-43.

92. Vertical price restraints, for instance, insure that no manufacturer is cheating on the cartel. H. HOVENKAMP, *supra* note 37, § 9.2, at 252; Calvani & Berg, *supra* note 3, at 1184; Piraino, *supra* note 58, at 14. Baxter argues that the following are required for vertical restraints to facilitate a manufacturer cartel: the manufacturers' market must be highly concentrated; substantially all manufacturers must use the restraint; there must be significant barriers to entry at the manufacturers' level; and, a substantial preponderance of the product sold at the dealers' level must be subject to the restraints. Baxter, *supra* note 1, at 942.

93. Baxter, *supra* note 1.

94. H. HOVENKAMP, *supra* note 37, § 9.2, at 249-50; R. POSNER, ANTITRUST LAW, *supra* note 1, at 148; Baxter, *supra* note 1, at 944-45; Calvani & Berg, *supra* note 3, at 1184.

95. Calvani & Berg, *supra* note 3, at 1184. H. HOVENKAMP, *supra* note 37, at 250 (arguing that the dealers cannot "buy" the manufacturer's cooperation because the manufacturer can keep all monopoly profits to itself by getting new dealers or vertically integrating); Easterbrook, *Vertical Arrangements*, *supra* note 27, at 142 ("A

Thus, in neither the manufacturer nor the dealer cartel is there a common plan between the manufacturer and the dealers to act in unison for their common good.

In short, in the vertical arrangement, there will not necessarily be the type of meeting of the minds or unity of purpose to work for a common plan that we saw in the typical horizontal arrangement. Instead, with vertical restraints the manufacturer and dealer will regard such restraints to be in their common good only when (1) the restraints are manufacturer-imposed rather than the result of a manufacturer or dealer cartel and (2) the dealer concurs in the manufacturer's judgment that a product-service package will appeal to consumers more than the product alone.[96] In other cases, the vertical restraint will be forced on an unwilling or indifferent dealer[97] or, in the case of a dealer cartel, an unwilling manufacturer.

V. THE SUPREME COURT CASE LAW OF VERTICAL RESTRAINTS

The Supreme Court decisions dealing with vertical restraints reflect almost eight decades worth of frustration from trying to fit a round peg into a square hole. All too often the Supreme Court has tried to transplant its decisions and rationale from the horizontal cases into the vertical cases. In particular, the Court's opinions reflect an unthinking assumption that the agreement element in the vertical arrangement is the same as that in the horizontal arrangement.

A. *The Early Cases:* Dr. Miles *Through* Sylvania

The first vertical restraint case to reach the Supreme Court was *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[98] which involved explicit resale price agreements between a manufacturer and its wholesalers and retailers. The presence of explicit agreements was unfortunate from an analytical viewpoint because the Court, not surprisingly, spent no time considering whether an agreement for antitrust purposes was present. An explicit agreement seemed intuitively to satisfy this element in the vertical arena just as it had in the horizontal arena.[99] Thus, the Court did not consider that given the inherent two-

manufacturer that helps dealers form a cartel is doing itself in. It will sell less and dealers will get monopoly profits.").

Many commentators argue that, unless the manufacturer has market power, a dealer cartel involving just one manufacturer will not be successful because consumers will simply switch to another brand. A dealer cartel, it is argued, can therefore only be successful if it is interbrand, that is, involves dealers of other competing brands. H. HOVENKAMP, *supra* note 37, § 9.2, at 249-50; Baker, *supra* note 1, at 1489; Easterbrook, *Vertical Arrangements*, *supra* note 27, at 142; Liebeler, *supra* note 32, at 19-23.

96. Even here, however, the dealer will simply be concurring in what is the manufacturer's plan. *See supra* note 87. *See generally*, Calvani & Berg, *supra* note 3, at 1201.

97. Much of the dispute between the Chicagoans and the traditionalists seemingly boils down to a disagreement over how often this "forcing" of dealers takes place. Under the Chicago view, the dealer should, more often than not, recognize the wisdom of the restraints (unless the dealer wishes to get a free ride). Under the traditionalist view, the forcing of restraints on dealers is more frequent and, of course, a greater concern.

98. 220 U.S. 373 (1911).

99. *See supra* notes 37-54 and accompanying text. Commentators have similarly fallen into the trap of assuming that because an express contact was present in *Dr. Miles*, an "agreement" for antitrust purposes was also necessarily present. *See, e.g.*, Anderson, *supra* note 3, at 917.

party nature of all vertical arrangements, some vertical agreements, even if in the form of explicit contracts, might fall outside the ambit of section one of the Sherman Act.[100] Rather, the combination of (1) an explicit agreement between otherwise independent firms, satisfying the agreement element, and (2) a fixing of prices, satisfying the restraint of trade element, was enough for the Court to doom the arrangement.[101]

The Court in *Dr. Miles* justified its decision on two grounds.[102] First, the Court relied on a trader-freedom rationale.[103] It noted that the manufacturer-imposed pricing restraints limited the dealer's freedom to market what were now the dealer's goods.[104] Second, the Court analogized the vertical price setting by Dr. Miles to a horizontal dealer cartel. Because the vertical restraint, as like a horizontal cartel, eliminated competition among dealers, the Court concluded that the vertical restraint was illegal.[105]

Within a few years, however, the Supreme Court recognized that there must be some legal two-party vertical arrangements, including some involving resale prices. In *United States v. Colgate & Co.*,[106] the Court attempted to carve out an exception. It held that where a manufacturer announced a desired resale price and then refused to sell to those dealers who did not sell at that price, there was no illegal arrangement and no Sherman Act violation.[107]

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100. *See supra* notes 55-59 and accompanying text.

101. The Court moved as quickly over the "restraint of trade" element as it did the "agreement" element. Early in its decision, the Court concluded: "That these agreements restrain trade is obvious." *Dr. Miles*, 220 U.S. at 400.

102. Both prongs of the *Dr. Miles* rationale have come under severe criticism. *See, e.g.*, H. HOVENKAMP, *supra* note 37, at 258-59; Baker, *supra* note 1, at 1465; Hay, *supra* note 2, at 419-22; Posner, *Antitrust Policy*, *supra* note 2, at 286-88; Shores, *supra* note 87, at 386-87.

103. "The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading . . . if there is nothing more, are contrary to public policy, and therefore void." *Dr. Miles*, 220 U.S. at 406.

104. Resale prices were regarded by the Court as primarily a matter of concern to the retailer, not the manufacturer. To the extent the manufacturer had a concern about resale prices, this concern was outweighed by society's interest in preserving the dealer's freedom of trade.

> The enlarged profits which would result from adherence to the established rates would go to [the retailers] and not to the complainant. . . . If there be an advantage to a manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell.

Id. at 407-08.

105. The Court reasoned the following:

> [Dr. Miles] can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. . . . But agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. . . . [Dr. Miles's] plan falls within the principle which condemns contracts of this class. It, in effect, creates a combination for the prohibited purposes.

Id. at 408 (citations omitted).

Commentators have argued that the Court was flatly wrong in its analogy. Manufacturer-imposed vertical restraints may be procompetitive because they result in increased interbrand competition; whereas a dealer cartel (if interbrand) restricts competition. *See, e.g.*, R. POSNER, ANTITRUST LAW, *supra* note 1, at 153 ("It makes all the difference whether minimum retail prices are imposed by the manufacturer in order to evoke point-of-sale services or by the dealers in order to obtain monopoly profits."). *See also* authorities cited *supra* in notes 65, 68 & 79. Scholars have also pointed out that an intrabrand dealer cartel is unlikely to be successful in raising prices because, unless the product is unique, consumers will switch brands. *See* authorities cited *supra* note 95.

106. 250 U.S. 300 (1919).

107. *Id.* at 307.

Unfortunately, in *Colgate*[108] and subsequent cases,[109] the Court used and abused the agreement element of the section one violation to try to distinguish between legal and illegal vertical arrangements. In the *Colgate*-type factual situation, no agreement was said to be present.[110] The manufacturer and complying dealer were said to be acting unilaterally.[111] However, as later cases showed, if the manufacturer went beyond the simple *Colgate* facts and conditioned his sales to dealers on an understanding that they would resell at specified prices, used others to help enforce his prices, or coerced the dealer, then an agreement was said to be present, and section one of the Sherman Act was violated.[112]

Obviously, the distinction drawn by *Colgate* and its progeny[113] between legal and illegal vertical arrangements was based on a highly strained and artifi-

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108. In *Colgate*, the issue, as framed by the Supreme Court, was whether the Government's indictment, as interpreted by the District Court, adequately charged an unlawful combination. *Id.* at 306.

109. *See* United States v. Parke, Davis & Co., 362 U.S. 29, 36-47 (1960); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); FTC v. Beech-Nut Packing Co., 257 U.S. 441 (1922); Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208, 210 (1921); United States v. A. Schrader's Son, Inc., 252 U.S. 85 (1920).

110.

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

Dr. Miles Medical Co. v. John D. Park & Sons Co., 250 U.S. 300, 307 (1919).

In justifying its decision, the Court thus used a trader-freedom rationale similar to that in *Dr. Miles* (although in *Colgate*, it was the manufacturer's freedom to deal that was seen as paramount). However, while talking of the manufacturer's right to choose with whom it would deal, the Court did not, as Professor Posner has noted, analyze *why* a manufacturer might want to avoid selling to price-cutting dealers. Posner, *Antitrust Policy*, *supra* note 2, at 288-89.

111. In *Colgate*, the Court seemingly accepted the District Court's contention that a dealer, faced with a manufacturer's announcement that he will not deal with those dealers not reselling at the suggested prices, acts unilaterally, even when he follows the manufacturer's suggestions. The Court quoted the District Court's statement:

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

Dr. Miles, 250 U.S. at 305-06.

112. In Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208, 210 (1921), the Court made clear that the *Dr. Miles* rule of illegality for vertical restraints applied to implied agreements as well as formal, explicit contracts. Thereafter, in subsequent cases, the Court focused on what kind of evidence was sufficient to support a finding of an implied agreement. *See* FTC v. Beech-Nut Packing Co., 257 U.S. 441 (1922); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944). By 1960, when the Court issued its opinion in United States v. Parke, Davis & Co., 362 U.S. 29 (1960), the Court had narrowed *Colgate* to the point that an agreement could be inferred if a manufacturer conditioned sales on adherence to resale prices, coerced dealers, or involved a third party in the policing of the resale prices. A detailed discussion of the vertical restraint cases from *Dr. Miles* to *Parke, Davis* is found in Levi, *The* Parke, Davis-Colgate *Doctrine: The Ban on Resale Price Maintenance*, 1960 SUP. CT. REV. 258. *See also* Calvani & Berg, *supra* note 3, at 1169-74; Floyd, *Vertical Antitrust Conspiracies After* Monsanto *and* Russell Stover, 33 KAN. L. REV. 269, 289-92 (1985).

113. *See supra* note 112. The lower courts had as much trouble as the Supreme Court in determining where the line between the legal (unilateral) vertical arrangement and the illegal (concerted action) vertical arrangement was to be drawn. In the search for the elusive "agreement," compulsion became a key factor (probably because of the dealer-freedom language in *Dr. Miles* and *Colgate*). Thus, the more the vertical arrangement was found to have been crammed down on the dealer, the more likely an "agreement" for antitrust purpose would be found. In Simpson v. Union Oil Co. of California, 377 U.S. 13, 17 (1964), the Supreme Court flatly stated that "a supplier may not use coercion on its retail outlets to achieve resale price maintenance." *See* VII P. AREEDA, *supra* note 3, at para. 1451.

cial interpretation of an agreement.[114] Certainly, an implicit agreement in some sense was present in the *Colgate* situation insofar as the manufacturer made his wishes known and the conforming retailers went along because they knew that they had to comply in order to continue receiving goods.[115] Indeed, as the Supreme Court itself acknowledged, the effect on the market was the same in the *Colgate* unilateral action situation as in the case where the manufacturer took some additional steps and thereby became part of an agreement.[116]

In the cases following *Colgate*, the Court expanded the range of action that might constitute an agreement and correspondingly narrowed the area of legal, two-party vertical arrangements.[117] In 1968 in *Albrecht v. Herald Co.*,[118] the Court again voiced its concern for trader freedom,[119] and took such a broad view of the agreement element that it came close to holding that there was no legal two-party vertical arrangement, at least if it involved prices.[120] The major-

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114. The *Colgate* decision, not surprisingly, has spawned a considerable amount of comment over the years. Scholars are virtually unanimous in denouncing *Colgate's* unilateral action/agreement distinction as artificial and formalistic. *See, e.g.*, Baker, *supra* note 1, at 1474; Piraino, *supra* note 58, at 10-11; Shores, *supra* note 14, at 303. *See also*, VII P. AREEDA, *supra* note 3, at para. 1445 (suggesting that *Colgate* can be reconciled with *Dr. Miles* on the basis of a distinction between simple implementation and complex enforcement of resale prices).

115. Professor Baker has observed: "It does not strain common usage to find concerted action where systematic refusals to deal are used successfully as bludgeons to compel compliance with announced policy." Baker, *supra* note 1, at 1474. Similarly, Professor Turner has stated:

> The short of the matter is that a distinction between a program of resale price maintenance effected by contracts and 'agreements,' and one effected by threats of refusal to deal, is wholly untenable as a practical or logical matter unless 'agreement' is defined to exclude tacit or implied agreements [which the Court did not do].

Turner, *supra* note 3, at 686-87.

116.

> The Sherman Act forbids combinations of traders to suppress competition. True, there results the same economic effect as is accomplished by a prohibited combination to suppress price competition if each customer, although induced to do so solely by a manufacturer's announced policy, independently decides to observe specified resale prices. So long as *Colgate* is not overruled, this result is tolerated . . . .

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

117. *See supra* note 112. By 1982, the FTC had concluded that *Colgate* was no longer good law. Russell Stover Candies, Inc. v. FTC, 100 F.T.C. 1, 7 (1982), *rev'd*, 718 F.2d 256 (8th Cir. 1983).

118. 390 U.S. 145 (1968).

119. "[A]greements to fix . . . prices . . . 'cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.'" Albrecht v. Herald Co., 390 U.S. 145, 152 (1968). In *Albrecht*, this concern for the dealer's freedom outweighed any interest the manufacturer had in enforcing resale prices. In footnote seven of its opinion, the Court specifically referred to the manufacturer's interest in imposing minimum resale prices as a way of creating nonprice interbrand competition.

> As a theoretical matter, it is not difficult to conceive of situations in which manufacturers would rightly regard minimum resale price maintenance to be in their interest. Maintaining minimum resale prices would benefit manufacturers when the total demand for their product would not be increased as much by the lower prices brought about by dealer competition as by some other nonprice, demand-creating activity.

Albrecht, 390 U.S. at 151 n.7.

However, even though the Court was willing to recognize the manufacturer's interest in resale prices, the Court was not willing to put this interest ahead of society's interest in maintaining the dealer's freedom to market the product as he saw fit.

120. In his dissent, Justice Harlan criticized the majority for not candidly stating this conclusion:

> The Court's difficulties on all of its theories stem from its unwillingness to face the ultimate conclusion at which it has actually arrived: it is unlawful for one person to dictate price floors or price ceilings to another; any pressure brought to bear in support of such dictation renders the dictator liable. . . . The reason for the Court's reluctance to state this conclusion bluntly is transparent: this statement of the matter takes no account of the absence of a combination or conspiracy.

Id. at 162.

ity of the Court held that an antitrust agreement could be found between the manufacturer and a third-party nondealer or between a manufacturer and a replacement dealer.[121] Perhaps even more intriguing is the Court's dicta[122] that an antitrust agreement could also be found between (1) a manufacturer and the plaintiff-dealer if the plaintiff-dealer complied with the manufacturer's requests and (2) a manufacturer and its other dealers, where those dealers complied with the manufacturer's requests.[123] Given any such agreement and a fixing of resale prices, there is a per se violation of section one.[124]

Justice Harlan, in his *Albrecht* dissent, recognized the problem with the Court's repeated use of the unilateral action—agreement distinction for vertical restraints. Harlan contended that the place to start in sorting out legal from illegal arrangements was not with a search for an agreement in some abstract sense but with the purpose of the Sherman Act. The primary purpose of the Act, he said, was not to protect trader freedom,[125] but to prohibit the "much more significant evil of lessened competition"[126] that comes about when firms conspire horizontally and thereby increase their market power.[127] Harlan concluded that the Court's task in assessing a vertical restraint was to determine whether, in fact, that arrangement was actually a mechanism for enforcing a

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121. In *Albrecht*, the defendant newspaper publisher set maximum resale prices to be charged by independent carriers who bought the newspapers at wholesale and sold them at retail. When the plaintiff carrier began charging more than the maximum price set by the publisher, the publisher hired an outside company (Milne Circulation) to solicit the plaintiff's customers and hired a replacement carrier (Kroner) to service these customers. The defendant also told the plaintiff that the plaintiff could have its customers back as long as the plaintiff charged the suggested price. *Id.* at 147-48. In this situation, the Supreme Court held that the plaintiff had shown an agreement between the defendant and Milne Circulation as well as an agreement between the defendant and Kroner. *Id.* at 150.

122. In its famous footnote six, the Court stated the following:

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

Id. at 150 n.6.

Following the *Albrecht* decision, lower courts frequently found the agreement element to be satisfied by evidence that the plaintiff dealer acquiesced in the manufacturer's pricing demands or by evidence that other dealers had acquiesced. *See* VII P. AREEDA, *supra* note 3, at para. 1443-44.

123. The Court in *Albrecht* showed some awareness that the vertical agreements it was condemning were different from illegal horizontal agreements. In particular, the Court recognized that where an agreement regarding maximum prices was found to exist between a manufacturer and an unwilling, but complying, dealer, the agreement could not be said to benefit both parties. Nonetheless, there could, according to the majority, be an "agreement" for section one purposes in such a vertical arrangement. Albrecht v. Herald Co., 390 U.S. 145, 152 n.8 (1968).

124. *See, e.g.*, United States v. Arnold Schwinn & Co., 388 U.S. 365, 379 (1967); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 (1959) (voicing concern for trader freedom).

125. Justice Harlan acknowledged that "one of the objectives of the Sherman Act was to preserve . . . a high degree of independence," but contended that "[r]ecognition of this objective does not . . . require this Court to hold that every commercial act that fetters the freedom of some trader is a proper subject for a *per se* rule. . . ." *Albrecht*, 390 U.S. at 158.

126. *Id.* at 159.

127. The premise of § 1 adjudication has always been that it is quite proper for a firm to set its own prices and determine its own territories, but that it may not do so in conjunction with another firm with which, in combination, it can generate market power that neither would otherwise have.

Id. at 160-61.

horizontal agreement among dealers or manufacturers.[128] Harlan noted that rather than doing this directly, however, the Court adopted a proxy or "rough approximation" through its test for an agreement,[129] leading to distinctions "more apparent than real."[130]

In 1977, the Supreme Court in its opinion in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[131] addressed for the first time the dilemma Justice Harlan suggested in his dissent in *Albrecht*: that the various goals of the Sherman Act might pull in different directions in the area of vertical restraints. At issue in *Sylvania* were certain location restrictions imposed by a manufacturer on its retailers. In analyzing the market effect and, in particular, the horizontal effect of such vertical restraints, the Court acknowledged that vertical restraints, at least vertical nonprice restraints, may be economically efficient.[132] The Court noted that while such restraints may reduce intrabrand competition,[133] they also "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[134] Thus, vertical nonprice

128. Justice Harlan believed that it might be proper to infer a horizontal dealer cartel in the case of minimum resale price maintenance. *Albrecht*, 390 U.S. at 162. Justice Harlan came to this conclusion because he believed, contrary to the views of the Chicago School (*see supra* note 81) that minimum resale prices benefitted dealers by giving them larger profit margins. *Id.* at 157-58. Furthermore, Justice Harlan was willing to accept a lessening of horizontal intrabrand competition as grounds for making minimum resale price maintenance per se illegal. *Id.* at 157. Justice Harlan, however, argued vigorously that maximum resale price fixing should be treated differently because (1) it benefits consumers and (2) the dealers, getting no benefit from maximum prices, are unlikely to conspire among themselves to bring about such price ceilings. *Id.* at 159. Many commentators agree with Justice Harlan that maximum resale prices should be seen as procompetitive. *See, e.g.*, H. HOVENKAMP, *supra* note 37, § 93, at 265; Popofsky & Bomse, *supra* note 2, at 72; Blair & Shafer, *Evolutionary Models of Legal Change and The* Albrecht *Rule*, 32 ANTITRUST BULL. 989 (1987); Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886 (1981). The Supreme Court may have an opportunity to revisit the issue in USA Petroleum v. Atlantic Richfield Co., 859 F.2d 687 (9th Cir. 1988), *cert. granted*, 109 S. Ct. 2446 (June 5, 1989).

129. Instead of undertaking to analyze when this inference [of a retailer cartel] would be proper, the Court has in the past followed the rough approximation adopted in *Parke, Davis*: there is no 'combination' when a manufacturer simply states a resale price and announces that he will not deal with those who depart from it; there is a combination when the manufacturer goes one inch further.

Albrecht, 390 U.S. at 162-63 (footnote omitted).

130. Albrecht v. Herald Co., 390 U.S. 145, 163 (1968).

131. 433 U.S. 36 (1977).

132. The Court expressly left untouched the per se rule for vertical price restraints. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977). In doing so, the Court looked to a justification grounded in economic efficiency. The Court thus distinguished price from nonprice restraints on the basis that price restraints might facilitate horizontal cartelizing. *Id.* In his concurring opinion, Justice White questioned whether such a distinction could be validly made and concluded, "The effect, if not the intention, of the Court's opinion is necessarily to call into question the firmly established *per se* rule against price restraints." *Id.* at 70. Since the *Sylvania* decision, a number of scholars have questioned the price/nonprice distinction. *See supra* note 67.

133. "Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers." 433 U.S. at 54. Professor Hovenkamp argues that it is wrong to even speak of a reduction of intrabrand competition because the vertical restraints do not restrict output even in the intrabrand market. H. HOVENKAMP, *supra* note 37, at 268-69. *See also* Liebeler, *supra* note 32, at 2-6 (criticizing the Court for failing to properly distinguish interbrand and intrabrand restraints).

134. *Sylvania*, 433 U.S. at 54. The Court went on to describe the various ways in which a manufacturer could use vertical restrictions to compete more effectively against other manufacturers, including the provision of services by dealers. *Id.* at 55. In doing so, the Court specifically alluded to the free rider problem that the manufacturer would encounter if it did not enforce the restrictions with regard to all his dealers. *See supra* note 72.

restraints, far from decreasing the horizontal competition among competitors, could actually increase it.[135]

Having recognized the potential economic efficiency of vertical nonprice restraints, the Court then addressed the issue of whether such market efficiency outweighed the competing goal of preserving "the autonomy of independent businessmen."[136] Forced to choose between economic efficiency and trader freedom, the Court echoed the earlier views of Justice Harlan in *Albrecht*[137] and came down squarely on the side of economic efficiency.[138] Horizontal interbrand competition, the Court asserted, "is the primary concern of antitrust law."[139] While vertical restrictions may impede dealer freedom, "an antitrust policy divorced from market considerations would lack any objective benchmarks."[140] Given the procompetitive (interbrand) potential of vertical nonprice restraints, the Court concluded that vertical restraints must be judged under the rule of reason.[141]

Although the Court in *Sylvania* did come to grips with one piece of the vertical restraint puzzle, the potential problem of different antitrust policies leading to divergent results,[142] the Court left untouched the agreement element of vertical restraints. Indeed, since the parties had stipulated to the presence of an agreement, the Court was able to and did sidestep this thorny issue altogether.[143]

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135. The Court also recognized, and seemingly accepted, the notion that a manufacturer is best served by reducing his costs of distribution and that, therefore, the manufacturer's interest and consumer's interest coincide in the area of vertical restraints. *Sylvania*, 433 U.S. at 56 n.24. *See supra* note 81.

136. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 53 n.21 (1977). Justice White, who had authored the opinion in *Albrecht*, expressed concern in his concurring opinion in *Sylvania* that "independent businessmen should have the freedom to dispose of the goods they own as they see fit." *Id.* at 66-67.

137. *See supra* notes 125-30 and accompanying text.

138. *Sylvania*, 433 U.S. at 53 n.21. In rejecting the trader-freedom rationale, the Court was, ironically, rejecting the purported justification underlying *Colgate* while, at the same time, broadening the manufacturer's rights vis-a-vis its dealers. *See*, Baker, *supra* note 1, at 1483-84; Shores, *supra* note 87, at 398.

139. *Sylvania*, 433 U.S. at 52 n.19.

140. *Id.* at 53 n.21.

141. *Id.* at 58-59. In so holding, the Court overruled its earlier decision in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

142. While the Court in *Sylvania* made great strides in analyzing the nature of the vertical arrangement, the Court's opinion can be, and has been, criticized in a number of respects. Commentators have argued, for instance, that the distinction drawn between price and nonprice restraints is unsupportable. *See, e.g.*, Allison, *An Analysis of the Vertical Price-Nonprice Dichotomy*, 21 AKRON L. REV. 131, 163-65 (1987); Baker, *supra* note 1, at 1467; Hay, *supra* note 2, at 429-30; Piraino, *supra* note 58, at 15; Posner, *The Next Step*, *supra* note 8, at 10. They have also noted that the Court gave no meaningful guidance for applying the rule of reason to vertical nonprice restraints. *See, e.g.*, H. HOVENKAMP, *supra* note 37, § 9.4, at 269; Posner, *The Next Step*, *supra* note 8, at 8, 18-21. Finally, some commentators contend that the Court in *Sylvania* did not carry its analysis far enough and declare all vertical restraints per se or presumptively legal. *See, e.g.*, Easterbrook, *Vertical Arrangements*, *supra* note 27, at 135; Posner, *The Next Step*, *supra* note 8, at 24-28.

143. The Court noted: "Although Sylvania contended in the District Court that its policy was unilaterally enforced, it now concedes that its location restriction involved understandings or agreements with the retailers." Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 40 n.8 (1977). Here again, the assumption of the parties (and the lower courts) was that an express contractual arrangement satisfied the agreement element of the section one case. *See supra* note 99 and accompanying text.

B. *The Recent Cases:* Monsanto *and* Business Electronics

In the last five years, the Supreme Court has issued two decisions on vertical restraints. Unfortunately, these two decisions only exacerbate rather than alleviate the confusion surrounding the vertical agreement.

In *Monsanto Co. v. Spray-Rite Serv. Corp.*,[144] the Court dealt squarely with the "agreement" element of a vertical restraint for the first time since *Albrecht*. The question in *Monsanto* was whether evidence that a manufacturer had received complaints from its distributors about another distributor and subsequently acted in a way consistent with those complaints was sufficient to indicate a Sherman Act agreement with the complaining distributors.[145]

In analyzing this issue, the Court in *Monsanto* expressly returned to the notion that there must be legal, two-party vertical cooperative arrangements.[146] Emphasizing again the efficiency-enhancing potential of vertical arrangements,[147] the Court noted that "[a] manufacturer and its distributors have legitimate reasons to exchange information about the prices and the reception of their products in the market."[148] In fact, "in order to assure an efficient distribution system," the Court stated "manufacturers and distributors constantly *must* coordinate their activities to assure that their product will reach the consumer persuasively and efficiently."[149]

Yet, to separate such legal communications and distribution arrangements from illegal ones,[150] the Court once again fell back on the "unilateral action" versus "agreement" distinction[151] of *Colgate*.[152] Under this approach, the Court concluded that complaints from distributors about other price-cutting distributors are "natural" and not indicative of "illegal concerted action,"[153] and that merely showing that a manufacturer acted in response to such complaints did

144. 465 U.S. 752 (1984).

145. In *Monsanto*, the plaintiff distributor alleged that Monsanto had received complaints from other distributors about the plaintiff's discount pricing and that Monsanto had conspired with its other distributors to set resale prices. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 756-59 (1984).

146. *See supra* notes 55-59 and 106-12 and accompanying text.

147. The *Monsanto* Court noted the following:

> [I]t is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' resale prices. The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that "free-riders" do not interfere.

Monsanto, 465 U.S. at 762-63.

148. *Id.* at 762. The manufacturer was said to have a "strongly felt" and "legitimate" concern about resale prices. *Id.* at 762-63.

149. *Id.* at 763-64 (emphasis added). As in *Sylvania*, the objection to vertical restraints was seen, not in their curtailment of the dealer's freedom, but in their facilitation of horizontal cartels. *Id.* at 762 n.7.

150. The Court declined the Solicitor General's suggestion that it reconsider the per se illegality rule for resale price maintenance. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761-62 n.7 (1984).

151. "[I]t is of considerable importance that independent action by the manufacturer . . . be distinguished from price-fixing agreements, since under present law the latter are subject to *per se* treatment and treble damages. On a claim of concerted price fixing, the antitrust plaintiff must present evidence sufficient to carry its burden of proving that there was such an agreement." *Monsanto*, 465 U.S. at 763.

152. Professor Hay has remarked that "the impact of the *Monsanto* Court's reaffirmation of *Colgate* . . . may be to breathe more life into *Colgate* than it had even in 1918." Hay, *supra* note 2, at 434.

153. *Monsanto*, 465 U.S. at 763.

not, by itself, prove the existence of an unlawful agreement.[154] The manufacturer could have received the complaints and communicated with its dealers but nonetheless have acted unilaterally.[155]

Having found no agreement when a manufacturer acts in response to dealer complaints, the Court was then faced with the task of explaining what added factor would turn such unilateral action into an illegal antitrust agreement.[156] In doing so, the Court ignored the differences between horizontal and vertical arrangements and simply transplanted the language and rationale of the horizontal cases. The Court stated that the "something more" needed to prove a vertical agreement was evidence "that the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.' "[157] Quoting the horizontal conspiracy case *American Tobacco Co. v. United States*,[158] the Court said the "[c]ircumstances must reveal 'a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement.' "[159] Applying this test in the vertical context means there must be "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributor were acting independently,"[160] and, in particular, there must be "more than a showing that the distributor conformed to the suggested price."[161] There must also be evidence "both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer."[162]

In transplanting the "common plan" or "unity of purpose" type of agreement from the horizontal to the vertical context,[163] the Court seemingly ignored the unwilling and indifferent dealer situations[164] and focused instead on just the

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154. *Id.* at 764.

155. While it used the *Colgate* "unilateral action" approach to carve out a niche of legal two-party vertical arrangements, the Court in *Monsanto* recognized the shortcomings of the Colgate agreement/unilateral action distinction. For one thing, the market impact or "economic effect" of conduct that *Colgate* deemed unilateral (and therefore legal) was often "similar or identical" to conduct deemed concerted (and therefore illegal). *Id.* at 762 (1984). Second, the Court candidly admitted that "judged from a distance, the conduct of the parties in the various situations can be indistinguishable." *Id.*

156. It can, of course, be argued that when a manufacturer receives complaints from dealers and acts in response to them, the manufacturer has already stepped over the line and formed an "agreement" with the complaining dealers. *See* Shores, *supra* note 14, at 270. *See also* Floyd, *supra* note 112, at 273-85.

157. *Monsanto*, 465 U.S. at 764 (quoting Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981)).

158. 328 U.S. 781 (1946).

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

160. *Id.*

161. *Id.* at 764 n.9.

162. *Id.*

163. *See supra* notes 55-97 and accompanying text. After *Monsanto*, the lower courts have been struggling with the problem of what type of evidence will supply the "something more" necessary to show a "meeting of the minds" or a "common plan." *See, e.g.*, Parkway Gallery Furniture, Inc. v. Kittinger/Pennsylvania House Group, Inc., 878 F.2d 801, 803-06 (4th Cir. 1989); Jeanery Inc. v. James Jeans, Inc., 849 F.2d 1148, 1157-60 (9th Cir. 1988); Isaksen v. Vermont Castings, Inc., 825 F.2d 1158, 1162-64 (7th Cir. 1987); Helicopter Support Sys. v. Hughes Helicopter, 818 F.2d 1530, 1534-36 (11th Cir. 1987). *See* Flynn, *supra* note 29, at 1104-10 (collecting cases). *See also* Allison, *Complaining Dealers, The Terminated Price Cutter, and Sherman Act Conspiracy Doctrine*, 22 AM. BUS. L.J. 467, 486-501 (1985).

164. *See supra* notes 77-97 and accompanying text. *See also* VII P. AREEDA, *supra* note 3, para. 1438c at 11.

willing dealer.[165] Quite simply, the *Monsanto* decision seemed to demand the presence of a dealer who willingly went along with the plan,[166] because he believed the restraints to be in his best interests,[167] and thereby had a unity of purpose or a common design[168] with the manufacturer.[169]

Adding to the confusion, the Court made no attempt to tie its discussion of the vertical agreement and the necessary willing dealer to the type of activity the Court was attempting to prohibit under section one.[170] Thus the Court offered no explanation of how the existence of a common plan and willing dealer might be linked to an economically inefficient, or otherwise undesirable, activity while a grudging, quiet acceptance of restraints by an intimidated dealer might promote efficiency.[171]

The logical inconsistency engendered by *Monsanto* was only worsened by the Court's 1988 decision in *Business Electronics v. Sharp Electronics*.[172] In *Business Electronics*, the manufacturer, Sharp, had two dealers in the Houston area—Hartwell and the plantiff, Business Electronics. Hartwell complained to Sharp about the plaintiff's price-cutting and gave Sharp the ultimatum that, unless Sharp terminated the plaintiff's dealership, Hartwell would cease being a Sharp dealer. Sharp subsequently terminated the plaintiff's dealership,[173] and the plaintiff sued, alleging a per se illegal agreement between Sharp and Hart-

165. *See* Jeanery Inc. v James Jeans, Inc., 849 F.2d 1148, 1156 n.6 (9th Cir. 1988) (questioning whether the manufacturer-unwilling dealer conspiracy suggested in *Albrecht* survives *Monsanto*); Garment Dist., Inc. v. Belk Stores Servs., Inc., 799 F.2d 905, 909 (4th Cir. 1986) (coercion is irrelevant after *Monsanto*); Sample, Inc. v. Pendleton Woolen Mills, Inc., 704 F. Supp. 498, 503 (S.D.N.Y. 1989). Some lower courts, even after *Monsanto*, continue to look to coercion as a factor that can transform unilateral action into concerted action. *See, e.g.*, Parkway Gallery Furniture, Inc. v. Kittinger/Pennsylvania House Group, Inc., 1988-1 Trade Cas. (CCH) para. 67,970 at 57,945 (M.D.N.C. 1988), *aff'd*, 878 F.2d 801 (4th Cir. 1989); Flynn, *supra* note 29, at 1107. *See also* Floyd, *supra* note 112, at 298. Professor Areeda suggests that *Monsanto* can be read as drawing a distinction between simple complex refusals to deal. VI P. AREEDA, *supra* note 3, para. 1446a at 83.

166. Indeed, earlier in its opinion, the Court had stated that a dealer who grudgingly went along with vertical restraints in order to avoid termination acted unilaterally. "A manufacturer of course generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently. . . . And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination." Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984).

167. Furthermore, by requiring that the manufacturer seek acquiescence and the dealer communicate his compliance, the Court suggested that it was looking for almost a contractual arrangement between the manufacturer and the willing dealer. The lower courts and scholars have concluded the Supreme Court could not possibly have meant to require such a strict showing. *See, e.g.*, Isaksen v. Vermont Castings, Inc., 825 F.2d 1158, 1164 (7th Cir. 1987) (Posner, J.); Hay, *supra* note 2, at 435.

168. *Monsanto*, 465 U.S. at 764. *See* Floyd, *supra* note 112, at 298.

169. The Seventh Circuit has taken the position that the Court could not possibly have meant to require a willing dealer. Isaksen v. Vermont Castings, Inc., 825 F.2d 1158, 1164 (7th Cir. 1987) (Posner, J.). Commentators have similarly concluded that "the Court's treatment of the contract, combination, or conspiracy requirement is exceedingly difficult to assess" because the Court failed to "define the outer boundaries of permissible behavior" in any "coherent fashion." Calvani & Berg, *supra* note 3 at 1198. *See also* Anderson, *supra* note 3, at 926, 938-42; Hay, *supra* note 2, at 435 (suggesting that, after *Monsanto*, legality of conduct will depend on the manufacturer's motive).

170. Scholars have also noted a disparity between the evidence of agreement that the Court *says* is necessary and what the Court in fact deemed sufficient in *Monsanto*. *See* Calvani & Berg, *supra* note 3, at 1193-97; Floyd, *supra* note 112, at 285-87.

171. Some scholars suggest that the failure to address this point can be explained by an underlying assumption on the Court's part that protecting the manufacturer's freedom to contract enhances market efficiency, regardless of the nature of the dealer's response. *See, e.g.*, Peritz, *supra* note 2, at 545.

172. 485 U.S. 717 (1988).

173. *Business Electronics*, 485 U.S. at 721.

well. In response to a special interrogatory, the jury found that Sharp and Hartwell had entered into an agreement and, pursuant to that agreement, Sharp had terminated the plaintiff because of the plaintiff's price-cutting.[174] The district court entered a judgment for the plaintiff. The Fifth Circuit reversed,[175] holding that the jury instructions and the interrogatory were erroneous because they did not require a finding that Sharp and Hartwell had expressly or impliedly agreed to set resale prices at a certain level.[176]

The issue framed by the Supreme Court was quite narrow. The jury had found that an agreement existed between Sharp and Hartwell to terminate the plaintiff because of price-cutting. Sharp did not directly challenge this finding on appeal.[177] The sole question, according to the Supreme Court, was whether price-fixing in the vertical context required evidence of the fixing of some specific price or price level.[178]

In analyzing this issue, Justice Scalia, writing for the majority of the Court, sided unequivocally with the Chicago School's view[179] that economic efficiency is the chief goal of the Sherman Act.[180] Scalia reiterated the language of *Sylvania* that a per se rule could be justified only where there was a "demonstrable economic effect."[181] While *Sylvania* suggested that the loss of horizontal intrabrand competition might be a concern of the antitrust laws,[182] Scalia specifically stated in *Business Electronics* that the law was concerned, at least in application of the per se rule, exclusively with activity that facilitated the kind

174. The district court described the special interrogatory (which the jury answered affirmatively) as follows: "Question number 1 asks you whether you find by a preponderance of the evidence that there was an agreement or understanding between Sharp and Hartwell to terminate Business Electronics as a Sharp dealer because of Business Electronics' price-cutting." Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212, 1215 (5th Cir. 1986), *aff'd*, 485 F.2d 1212 (1988).

175. *Business Electronics*, 780 F.2d at 1212.

176. "[W]e hold that, in order for a manufacturer's termination of a distributor to be illegal *per se*, it must be pursuant to a price maintenance agreement with another distributor. That distributor must expressly or impliedly agree to set its prices at some level, though not a specific one." *Id.* at 1218. The Fifth Circuit remanded the cases for retrial under proper instructions. The court rejected Sharp's contention that the evidence was insufficient to raise a jury question regarding a possible Sharp-Hartwell agreement on resale prices. *Id.* at 1218-19.

177. *See* Brief for Respondent Sharp Electronics before the Supreme Court, Supplemental Brief for Respondent/Cross Peititioner & Brief in Opposition to Petition for Writ of Certiorari, Business Electronics Corp. v. Sharp Electronics Corp., 108 S. Ct. 1515 (1988) (No. 85-1910); Cross Petition for Writ of Certiorari, Sharp Electronics Corp. v. Business Electronics Corp., 108 S. Ct. 1727 (1988) (No. 85-2094).

178. *Business Electronics*, 485 U.S. at 726-27. The Supreme Court's decision thus technically dealt with the "to fix prices" prong of the vertical price fixing case and not with the "agreement" prong. *See supra* notes 11-12 and accompanying text. In horizontal price-fixing cases, the Supreme Court had held in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 222-23 (1940), that agreement on a specific price or price level was not necessary; price stabilization was sufficient to constitute an offense.

179. *See supra* notes 26-28 and 63-73 and accompanying text.

180. Economic efficiency was the sole ground, at least, for the application of the per se illegality rule. The Court left open the question of whether there were other, noneconomic goals of the Sherman Act and when and if a rule of reason challenge was appropriate where a vertical restraint transgressed these other goals. *See infra* note 222 and text accompanying notes 247-53.

181. Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 726 (1988) (quoting from Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 59 (1977)).

182. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51-54 (1977). A number of scholars had criticized the *Sylvania* Court's discussion of intrabrand harm and interbrand benefits on the ground that an intrabrand cartel, although horizontal in form, does not affect the interbrand market or reduce efficiency. *See, e.g.*, H. HOVENKAMP, *supra* note 37, § 9.4 at 267-69; Liebeler, *supra* note 32, at 6-8.

of horizontal interbrand[183] cartels that enable competing firms to "restrict competition and reduce output."[184] Thus, in determining whether a vertical restriction should be judged under the per se rule, the test essentially became: Is the vertical restraint likely to facilitate horizontal cartelization, either on the manufacturer level or on the dealer level?[185] Vertical nonprice restraints, Scalia explained, were judged under the rule of reason, and not the per se rule, precisely because "the cartel-facilitating effect of vertical nonprice restraints was and remains lacking."[186]

Using this approach, the Court concluded that a vertical pricing restraint should be judged under the per se rule only when a specific price or price level was agreed to by the manufacturer and the remaining dealer. Without an agreement on price, it was unlikely that a horizontal cartel would be facilitated since "the manufacturer both retains its incentive to cheat on any manufacturer-level cartel (since lower prices can still be passed on to consumers) and cannot as easily be used to organize and hold together a retailer-level cartel."[187] Scalia further reasoned that without an agreement on resale prices, courts may actually be condemning, on a per se basis, nonprice restraints that have a "real potential to stimulate interbrand competition."[188]

The *Business Electronics* decision is troubling in a number of respects. First, the ruling simply does not fit with the stated rationale. Instead, the Court

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183. The Court stated that "a rule of *per se* illegality . . . [is] not needed or effective to protect *intra*brand competition," *Business Electronics*, 485 U.S. at 725, and reiterated the *Sylvania* Court's determination that "interbrand competition is the primary concern of the antitrust laws." *Id.* at 726.

Justice Stevens, in his dissent, took issue with Justice Scalia on this point. Stevens cautioned that intrabrand competition has significant economic benefits for society:

> [A]lthough the majority neglects to mention it, fostering intrabrand competition has been recognized as an important goal of antitrust law, and although a manufacturer's efficiency-enhancing vertical nonprice restraints may subject a reduction of intrabrand competition only to a rule of reason analysis, a similar reduction without the procompetitive "redeeming virtues" of the manufacturer-imposed vertical nonprice restraints . . . causes nothing but economic harm.

Id. at 749 n.14.

184. *Id.* at 727. The Court later noted that "all anticompetitive effects are by definition horizontal effects." *Id.* at 730 n.4.

185. Vertical price restraints are per se illegal, the Court noted, because:

> [T]here [is] support for the proposition that vertical price restraints reduce *inter*brand price competition because they " 'facilitate cartelizing.' ". . . The authorities cited by the Court [in *Sylvania*] suggested how vertical price agreements might assist horizontal price fixing at the manufacturer level (by reducing the manufacturer's incentive to cheat on a cartel, since its retailers could not pass on lower prices to consumers) or might be used to organize cartels at the retailer level. (citations omitted)

Id. at 725-27. Justice Scalia went on to note, gratuitously, that "[c]artels are neither easy to form nor easy to maintain." *Id.* at 727.

186. *Id.* at 726.

187. *Id.* at 727.

188. *Id.* at 724. Scalia noted the problem with distinguishing a "price" from a "nonprice" vertical restraint.

> Any agreement between a manufacturer and a dealer to terminate another dealer who happens to have charged lower prices can be alleged to have been directed against the terminated dealer's "price cutting." In the vast majority of cases, it will be extremely difficult for the manufacturer to convince a jury that its motivation was to ensure adequate services, since price cutting and some measure of service cutting usually go hand in hand. . . . [A]ll vertical restraints . . . have the potential to allow dealers to increase "prices" and can be characterized as intended to achieve just that.

Id. at 727-28.

once again uses a proxy[189] instead of dealing directly with the problem of deciding which vertical restraints to term legal and which ones to term illegal. Under the rationale of the case, per se treatment (and, perhaps, legality)[190] of a vertical price restraint should turn on whether the restraint is actually part of a horizontal interbrand dealer or manufacturer cartel. Put simply, following the rationale of *Business Electronics*, there are no purely vertical restraints that are per se illegal.[191] Rather, to get per se treatment, the plaintiff must show a horizontal interbrand cartel either among dealers or manufacturers.

Yet the ruling of *Business Electronics* makes the application of per se treatment turn on whether the manufacturer specifies a particular resale price or price level to his dealer.[192] This ruling is both broader and narrower than the stated rationale.[193] For instance, there could be a manufacturer or dealer cartel pursuant to which the manufacturer terminated dealers who priced significantly below the suggested resale prices. Despite such cartel activity, if no specific price or price level were agreed to by the manufacturer and the remaining dealers, there would be no per se illegal vertical restraint. (Although, of course, if the terminated dealer could prove the existence of the cartel, there would be a per se illegal horizontal case.)[194] More important is the following hypothetical: Suppose there is no manufacturer or dealer cartel, but the manufacturer insists that the dealer agree to sell at a specific resale price. Such an arrangement would be illegal per se after *Business Electronics*, despite the lack of any type

189. Indeed, the Court has added a new proxy. In *Colgate* and *Monsanto*, the Court used the unilateral action/agreement proxy. Now the Court has added a "specific price" proxy. I am not alone in regarding this as an artificial proxy. *See* Liebeler, *Resale Price Maintenance and Consumer Welfare:* Business Electronics Corp. v. Sharp Electronics Corp., 36 UCLA L. REV. 889, 895-96 (1989).

190. While the Court in *Business Electronics* was, strictly speaking, only addressing the applicability of the per se rule, the thrust of Scalia's opinion suggests that, except where they facilitate horizontal interbrand cartels, vertical restraints should be treated as legal, a view supported by a number of Chicago School scholars. *See supra* note 58. In so suggesting, Scalia's opinion casts doubt on *Sylvania*'s holding that vertical nonprice restraints are at least open to challenge under the rule of reason. Retention of the right to challenge under the rule of reason may be a hollow victory. *See infra* note 252. Scalia, for instance, not only reiterated the procompetitive uses of vertical nonprice restraints, but also whittled down all restraints' anticompetitive effects to one: facilitating cartels. "[A]ll anticompetitive effects," he wrote, "are by definition horizontal effects." Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 730 n.4 (1988). Finally, he observes that if the plaintiff's argument was accepted, "[m]anufacturers would be likely to forgo *legitimate and competitively useful conduct* rather than risk treble damages and perhaps even criminal penalties." *Id.* at 728 (emphasis added). Arguably, "legitimate and competitively useful" conduct should not be subject even to rule-of-reason scrutiny. *Id.*

191. Peritz, *supra* note 2, at 550-51.

192. It may be harder than it appears to tell whether a manufacturer specified a price or price level. Assume, for instance, a manufacturer wants his dealer to charge a higher resale price (because, for instance, the manufacturer believes that with a higher resale price and higher revenues, the dealer will spend more on advertising). The manufacturer tells his dealer to raise prices. The dealer asks, "How high?" "I'm not specifying a price," responds the manufacturer (who's read the *Business Electronics* decision). "What if I raise my price by $1.00 per unit?" the dealer asks. "Getting warmer," the manufacturer responds. If the manufacturer and dealers find themselves playing the children's game of "getting warmer, getting colder," has there been a specifying of prices for purposes of *Business Electronics*? If not, is this the type of game-playing that the decision will encourage?

193. One possible (and obvious) explanation for the Court's behavior is that the Court was not fully confident of its premise that the only evil of vertical restraints is their potential to facilitate cartels.

194. Justice Scalia suggests that a cartel is unlikely to exist absent the setting of a specific resale price. *See supra* notes 187-88 and accompanying text. However, a manufacturer could achieve the objective of having his dealers selling at approximately the same price by threatening termination if the deviating dealers did not move their prices up. Over time, resale prices would come to be substantially identical without the manufacturer having to specify a resale price.

of horizontal cartel.[195] In short, the gap between the rationale and the ruling in *Business Electronics* means that some arrangements that do not offend the stated purpose of antitrust laws will nonetheless be caught in the per se net.[196]

By failing to make its ruling correspond with its rationale, the Court also sidestepped a nagging question in the vertical area: Is an explicit contract regarding resale prices, such as that found in *Dr. Miles*, an illegal agreement for section one purposes?[197] Under the *rationale* of *Business Electronics*, the answer would be not necessarily. A manufacturer and dealer could very easily enter into an explicit contract regarding resale prices without there being either a manufacturer or a dealer cartel.[198] However, because the *ruling* of *Business Electronics* focused on specific resale prices rather than on evidence of cartelizing, the long-standing assumption behind *Dr. Miles*—that an explicit contract is an agreement in both the vertical and horizontal areas[199]—continues as a live, but never analyzed, proposition of antitrust law.[200]

Perhaps more troubling is the fact that the rationale of *Business Electronics* is fundamentally at odds with the *Monsanto* decision. *Business Electronics* teaches that vertical restraints are dangerous to competition (and a concern of the antitrust laws) when there is a cartel at one level of the distribution chain that is using the vertical restraint as a means to enforce the horizontal cartel. In such a situation, however, the nonconspiring level of the distribution chain is not

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195. This could be the result in *Business Electronics* on remand. There was no evidence presented of a manufacturer or dealer cartel. However, the Fifth Circuit ruled that the plaintiff had made a showing sufficient to justify a jury inference that Sharp and Hartwell agreed on specific resale or price levels. Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212, 1218-19 (5th Cir. 1986).

196. Any horizontal cartels that escape the vertical per se rule of *Business Electronics* are less worrisome because they can be caught by the horizontal per se rules.

197. *See supra* notes 98-143 and accompanying text. Justice Stevens, in his dissent, clearly thought the answer was yes. "Quite obviously, if [Sharp] had agreed with either Hartwell or [Business Electronics] to discontinue its competitive pricing . . . those agreements would have been illegal *per se*." *Business Electronics*, 485 U.S. at 744.

198. If there was a manufacturer or dealer cartel, the cartel members might prefer an explicit contract on resale prices, rather than simply an implicit understanding, in order to ensure that those resale prices were actually charged. As the Court noted: "Cartels are neither easy to form nor easy to maintain. Uncertainty over the terms of the cartel, particularly the prices to be charged in the future, obstructs both formation and adherence by making cheating easier." *Id.* at 727. However, there could nonetheless be a manufacturer or dealer cartel carried on without explicit contracts on resale prices. Perhaps more significant is the potential for a manufacturer to enter into an express contract with its dealer regarding resale prices without being either part of a manufacturer cartel or the tool of a dealer cartel.

199. Ironically, the Court in *Business Electronics* was happy to distinguish between horizontal and vertical violations when the issue was price stabilization. Price stabilization by two parties was sufficient, according to the Court, for a horizontal violation but not sufficient for a vertical violation. *Business Electronics*, 485 U.S. at 734. Unfortunately, the Court was not so willing to explore the differences between a horizontal and a vertical violation insofar as the agreement element was concerned.

200. The majority, rather disingenuously, distinguished *Dr. Miles* on the ground that, because the *Business Electronics* jury had not found an agreement regarding resale prices, there could be no restraint on alienation, as was present in *Dr. Miles*. *Id.* at 733. Given the Court's rejection in *Sylvania* of the restraint-on-alienation rationale, it is hard to say on what ground *Dr. Miles* now rests.

The Court also distinguished *Albrecht* and *Parke, Davis*. *Albrecht* was distinguished on the grounds that the agreement there "involved both [1] an explicit agreement on resale price and [2] an agreement to force another to adhere to the specified price." *Id.* at 735. No explanation was given as to the relevance (other than historical interest) of the explicit agreement. With respect to the second element, coercion, see *infra* note 202. The Court disposed of *Parke, Davis* primarily on the ground that that case had also involved a horizontal agreement among dealers. *Business Electronics*, 485 U.S. at 735.

benefitted by the vertical restraints and can be expected to resist the restraints.[201] There will, therefore, be a forcing of the vertical pricing restraints on the dealers when there is a manufacturer cartel, and a forcing on the manufacturers when there is a dealer cartel.[202]

Yet *Monsanto* tells us that in looking for illegal vertical agreements, one should look for situations in which the manufacturer and dealer have a common plan, unity of purpose, and meeting of the minds.[203] The obvious problem with this test is that one will never (or, at least, only rarely) find a common plan between the manufacturer and dealer where the vertical restraints are being imposed pursuant to a cartel at one level of a distribution chain.[204] Thus, if courts search for the agreement that *Monsanto* condemns, they will seldom find the vertical arrangement that *Business Electronics* describes as anticompetitive.[205] On the contrary, by searching for common plan vertical arrangements, courts will be scrutinizing, and possibly condemning, the vertical arrangements that under the *Business Electronics* rationale are most procompetitive.[206] And, in seeking out the vertical arrangement that *Business Electronics* condemns, the plaintiff will unlikely be able to fulfill the agreement element enunciated by *Monsanto.*[207]

The *Business Electronics* decision is thus both internally inconsistent and fundamentally incompatible with *Monsanto.* Internally, the decision gives two different answers to the question: What does a plaintiff have to prove to win a per se vertical case? If the rationale of the Court is followed, no purely vertical

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201. *See supra* notes 77-97 and accompanying text.

202. The rationale of *Business Electronics,* unlike the *Monsanto* ruling, makes coercion a relevant factor. *See supra* notes 77-97 and accompanying text. One indication that Justice Scalia recognized coercion's significance under his reasoning in *Business Electronics* is seen in his reference to "forcing" as a grounds for distinguishing *Albrecht. See supra* note 199.

203. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 n.9 (1984). *See supra* notes 156-61 and accompanying text.

204. Professor Hovenkamp suggests that in a rare case a manufacturer might be bought off by a dealer cartel. Hovenkamp, *Antitrust Policy, Restricted Distribution, and the Market for Exclusionary Rights,* 71 MINN. L. REV. 1293, 1299 (1987).

205. For the same reason, the *Monsanto* test for an illegal agreement may also be impossible to apply between different levels of distribution in a boycott case. In the boycott area, courts have increasingly ruled that per se treatment should only be applied when there is some horizontal agreement among competitors. *See, e.g.,* Lomar Wholesale Grocery v. Dieter's Gourmet Foods, 824 F.2d 582, 590-91 (8th Cir. 1987); Fine v. Barry & Enright Prods., 731 F.2d 1394, 1398 (9th Cir.) *cert. denied,* 469 U.S. 881 (1984). While such a horizontal agreement would certainly satisfy the *Monsanto* test, there will probably be a "forcing" between the different levels of distribution.

206. If a manufacturer and a dealer have a "common plan" to enforce vertical restraints, it is probably because they both see a "package" of product plus service as the most competitive way to market the product. In this situation, the manufacturer could argue that it has simply acted in its own self-interest (although with the cooperation of complying dealers) in imposing the vertical restraints and that, therefore, the plaintiff cannot "exclude the possibility that the manufacturer . . . [was] acting independently" as *Monsanto* requires. Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 (1984). *See, e.g.,* Purity Prods., Inc., v. Tropicana Prods., Inc., 702 F. Supp. 564, 574-75 (D. Md. 1988). *See also* Calvani & Berg, *supra* note 3, at 1201. It is also conceivable that a manufacturer and dealer could have a "common plan" to charge an above-competition price to an unsuspecting customer and split the extra profits. *See, e.g.,* DeLong Equip. Co. v. Washington Mills Abrasive Co., 887 F.2d 1499 (11th Cir. 1989). Such a scheme, however, would generate only short-term profits and end when the customers realized there were cheaper competing products.

207. In the cartel situation, there is a "common plan" among the members of the cartel, but this has nothing to do with the vertical "agreement" between the manufacturer and the distributor.

arrangement is per se illegal.[208] The plaintiff, under the Court's reasoning, is required to show horizontal cartel activity in the interbrand market, either among dealers or manufacturers. If, on the other hand, the ruling of the case is followed, the successful plaintiff must show a specifying of a particular resale price or price level, even though this may have no bearing on the existence of a cartel.

When read in conjunction with *Monsanto*, moreover, the *Business Electronics* decision leads to hopeless confusion in trying to answer the question: What is the nature of the agreement between the manufacturer and the dealer that courts should be looking for in the vertical context? Here, if the rationale of *Business Electronics* is followed, then the teachings of *Monsanto* are no longer good law. Instead of the common plan agreement, courts should be looking for the coerced, cram-down arrangement.[209] Alternatively, if the ruling of *Business Electronics* is followed, under that decision and *Monsanto*, the prototype of the per se illegal vertical agreement ironically becomes the much-maligned[210] *Dr. Miles* case: an explicit contract under which the dealer agrees to charge a specific price.[211]

VI. Proposal: How to Bring Some Clarity to Vertical Restraints

The present state of the law of vertical restraints is clearly unacceptable. As the law stands now, it is logically impossible for a court to be faithful to both the letter of *Monsanto* and the spirit of *Business Electronics.*

The first step in bringing some order to this morass is to recognize five fundamental propositions for vertical restraints.

1. In the vertical area, unlike the horizontal area, the anticompetitive nature of the arrangement is not linked to a finding of a common plan or unity of purpose between the firms. On the contrary, under the Chicago economic efficiency view which the Supreme Court has increasingly adopted, an anticompetitive vertical arrangement is likely to involve some coercion between the two levels of distribution. (And an agreement in which there is a common plan between the manufacturer and the dealer is likely to be procompetitive.)[212]

2. Unless courts require that all manufacturers do their own retailing—a proposal that the Supreme Court clearly finds unacceptable[213]—a niche must be carved out for legal multiparty vertical arrangements. To avoid litigation ex-

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208. Also open is the status of the vertical rule of reason case. Is there a rule of reason vertical case for resale price maintenance? If a dealer cannot show that vertical pricing restraint is part of cartel activity, can he nonetheless get to the jury on a rule of reason case? *See infra* notes 246-53 and accompanying text.

209. *See supra* notes 92-95.

210. *See supra* note 103.

211. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). The Court in *Business Electronics* seemingly left untouched the price/nonprice distinction in vertical restraints. While Justice Scalia lamented the inability to distinguish between them in many instances, the distinction still stands. As to whether the rule of reason challenge for vertical nonprice restraints should be kept, see *infra* notes 243-50 and accompanying text.

212. *See supra* notes 77-97 and accompanying text.

213. The Supreme Court has repeatedly raised the spectre of manufacturers forced to integrate forward and do their own retailing, as a justification for relaxing the rules on vertical restraints. The Court has noted that such forward integration by manufacturers might harm the retailers more (by putting them out of business) than

penses and any chilling effects that come from potential antitrust scrutiny,[214] arrangements falling within this niche should not even be subject to rule of reason challenges.

3. "Agreement" (versus "unilateral action") is not the key to distinguishing legal and illegal vertical arrangements. Even legal vertical arrangements inevitably involve an implicit agreement in some sense. The slippery distinction between *Colgate*, on one hand, and *United States v. Parke, Davis & Co.*[215] and *Albrecht*,[216] on the other, is analytically and logically untenable and simply not worth the candle. Furthermore, under the Chicago School approach, most explicit contracts on resale prices are likely to be procompetitive, not anticompetitive.[217]

4. The specific price requirement of *Business Electronics* is no more helpful in distinguishing legal from illegal vertical arrangements. A manufacturer imposing a specific resale price is not necessarily a member or pawn of a cartel.[218]

5. The decision of where to draw the line between legal and illegal vertical arrangements must be made with the goals of the antitrust laws in mind. Unlike horizontal analysis, in the vertical area competing goals often point in different directions.

A. *How to Draw the Line*

Having rejected the agreement/unilateral action distinction as an unacceptable basis for differentiating legal and illegal vertical arrangements, the question then arises: What analytical grounds support carving out an area of legal vertical agreements? There are two possible grounds, based on the two central elements of the Sherman Act section one offense: agreement and restraint of trade.[219]

One option is to take the position that an "agreement" for purposes of section one of the Sherman Act means something different from the ordinary, everyday use of the term. Under this approach, only a subset of all "agreements" in the ordinary sense of the word would be antitrust agreements for Sherman Act purposes.[220] Put another way, the "agreement" element of the section one violation would be defined as something less than the ordinary use of

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vertical restraints. *See, e.g.*, Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 725 (1988); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 57 n.26 (1977).

214. *See infra* note 227 and accompanying text.

215. 362 U.S. 29 (1960).

216. *See supra* notes 118-30 and accompanying text.

217. They will be anticompetitive only when used to facilitate a cartel, an occurrence which the Chicago School adherents and the Supreme Court view as rare. *See supra* notes 90-95 and accompanying text.

218. To the extent dealer freedom is a concern of the antitrust laws, it too is largely unrelated to the dictation of a specific price. If a dealer is merely told to move his prices up (without a specific price being mentioned), he has still lost some of his freedom to make his own marketing decisions.

219. *See supra* notes 11-12 and accompanying text.

220. Taking the approach that the Sherman Act does not (and cannot) mean what it says is not new. As early as 1918, the Supreme Court acknowledged that the Act could not prohibit all "restraints of trade," despite the plain language of the statute. "Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence." Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918). *See also*, National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 688 (1978) ("[R]ead literally, § 1 would outlaw the entire body of private contract law.").

that term while the "restraint of trade" element would continue to be interpreted to include price-fixing.

Alternatively, "agreement" can be read in its ordinary, everyday sense, but the second element of the offense, restraint of trade, can be interpreted more narrowly so as to include only a limited number of vertical arrangements. Under this second approach, all vertical arrangements (including those in *Colgate*) would satisfy the "agreement" prong of the offense, but only a subset would satisfy the "restraint of trade" prong.[221]

Both of these approaches have the advantage of admitting that any vertical arrangement, whether it be an explicit contract or a *Colgate* "take-it-or-leave-it" announcement, involves an agreement in some sense. Both approaches also say that the law does not care, for antitrust purposes, about *all* vertical arrangements that constitute agreements. Under the first approach, the law is concerned with only a subset of agreements; under the second approach, antitrust scrutiny is reserved for those agreements that fall within the narrowed definition of restraint of trade.

While both approaches get the job done, the second is somewhat preferable simply because it does not involve tinkering with words of ordinary usage. The business person trying to understand antitrust law may be confused if he is told that the term "agreement" in the Sherman Act means something less than its ordinary and customary meaning. On the other hand, being told that certain practices are not considered restraints of trade is unlikely to have the same jarring effect.[222]

B. *Where To Draw the Line and What Evidence To Look For*

Where to draw the line between legal and illegal vertical restraints depends primarily on what goal one wishes to achieve through the Sherman Act. The Supreme Court seems close to adopting the view that economic efficiency is the sole goal of the Sherman Act.[223] The majority of the Court has indicated that it

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221. This is the approach supporting the openly-concerted horizontal arrangements that have procompetitive benefits. *See, e.g.*, Columbia Broadcasting Sys. Inc. v. ASCAP, 620 F.2d 930 (2d Cir. 1980), *on remand from* Broadcast Music Inc. v. Columbia Broadcasting Sys., 441 U.S. 1 (1979). *See supra* note 46.

222. The Supreme Court has recognized the need to interpret "restraint of trade" in light of "new circumstances and new wisdom." Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 732 (1988). Professor Easterbrook made the same point in his article, *Is There A Ratchet in Antitrust Law?*. Easterbrook, *Is There a Rachet, supra* note 27, at 706.

223. The Court has specifically said that intrusion on trader freedom is not sufficient to trigger the per se rule. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 53 n.21 (1977). In *Business Electronics*, neither the majority nor the dissent suggested that dealer freedom should be a concern in applying the per se rule. Rather, Justice Stevens' opinion was based in part on his view that intrabrand competition had important benefits to society as a whole. *See supra* note 183.

It should be noted that the Court has never expressly ruled out the possibility of using trader freedom or other noneconomic issues as factors in a rule of reason case. However, to the extent that the *Sylvania* Court described the factors important to a rule of reason analysis of a nonprice vertical restraint, it did so in terms of market effect. The decline in intrabrand competition, the Court said, was to be balanced against any procompetitive impact of the restraint in the interbrand market. *Sylvania*, 433 U.S. at 51-52. No mention was made in this calculus of a need to consider the intrusion on dealer freedom. On the other hand, in both *Sylvania* and *Business Electronics* the Court stated that deviation from the rule of reason must be justified by "demonstrable economic effect"—suggesting that "demonstrable economic effect" was *not* necessary for challenge (and even condemnaregards the horizontal interbrand[224] cartel as the chief threat to that efficiency.[225] Under this view, the obvious place to draw the line is between vertical agreements that are part of such cartels and vertical agreements that are not.[226] Logic dictates that vertical agreements not shown to be part of a horizontal interbrand cartel should be per se or presumptively legal.[227] Those that are the result of such cartelizing, on the manufacturer or dealer level, should be illegal.[228]

In looking for such an illegal vertical arrangement, a trier of fact should be seeking, among other things, evidence that the vertical restraint was forced upon one level of the distribution chain by a firm or firms at another level.[229] Despite *Monsanto*'s recent vintage, the Supreme Court should acknowledge that the case's requirement of a "common plan" and "unity of purpose" is simply wrong when applied to vertical arrangements.

Not every forced vertical restraint, however, will result from a cartel. It can just as easily stem from an honest disagreement between a manufacturer and his dealers regarding the best way to market a product.[230] The question therefore arises: Assuming the Court continues to stress the goal of economic efficiency, what should be the plaintiff's burden of proof?

First, will evidence of coercion or a forced restraint, in itself, be enough to get the plaintiff to the jury? The probable answer is no. For one thing, permitting a plaintiff to establish a prima facie case based solely on evidence of coercion may discourage a manufacturer from going forward with vertical restraints any time his dealers do not agree that the restraints will be product-enhancing. And in *Business Electronics* the Supreme Court expressed concern about drawing lines which might cause the forbearance of "legitimate and competitively useful conduct" due to producers' fear of antitrust penalties.[231] Furthermore, absent evidence of a cartel, a jury presented with some showing of coercion may

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tion) under the rule of reason. *Id.* at 59; *Business Electronics*, 485 U.S. at 726. As to whether a rule of reason challenge should be retained see *infra* notes 246-53 and accompanying text.

224. The dissenting Justices in *Business Electronics* argued that a loss of intrabrand competition was also a threat to economic efficiency. *See supra* note 183.

225. In *Business Electronics* the majority left open the possibility that there might be other activity that affects economic efficiency. The Court said that application of the per se rule must be justified by "demonstrable economic effect, *such as* the facilitation of cartelizing . . . ." *Business Electronics*, 485 U.S. at 726 (emphasis added). Professor Hovenkamp suggests two types of evidence, other than evidence of cartelizing, that should be required to condemn a vertical restraint (whether price or nonprice): (1) evidence that the manufacturer has market power (so that restraint of the intrabrand market will also restrain the interbrand market) and (2) evidence that the manufacturer is using the vertical restraint to facilitate price discrimination. H. HOVENKAMP, *supra* note 37, § 9.3, at 257 and § 9.4, at 271.

226. This is essentially the proposal made in 1960 by Justice Harlan in his dissenting opinion in Albrecht v. Herald Co., 390 U.S. 145, 162-63 (1968), although Harlan (like Justice Stevens) would have considered loss of intrabrand competition as a threat to efficiency. *See supra* note 128.

227. This is the conclusion advanced by a number of Chicagoans. *See supra* note 58.

228. Restraints found to be part of some other anticompetitive activity would be treated the same as those associated with a cartel. *See supra* note 225.

229. Ironically, coercion, which played a large role in vertical restraint cases during the heyday of the trader-freedom rationale, is now important in determining whether a vertical restraint is part of a cartel and therefore economically inefficient. *See supra* notes 113 and 202.

230. *See supra* notes 84-87 and accompanying text.

231. Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 726 (1988). In *Monsanto*, the Court similarly noted that "[p]ermitting an agreement to be inferred merely from the existence of complaints, or

well be put in the position of trying to delve into the manufacturer's state of mind.[232] (For instance, was the manufacturer persuaded by complaining dealers that vertical restraints would enhance his product's marketability? Or, was he knuckling under to a dealer cartel?)[233] Here again, in its recent cases the Supreme Court has specifically backed away from rules that require any such divining of a manufacturer's motive.[234]

A second question is: Will the plaintiff be able to get to the jury by showing that two or more dealers acted together in pressuring the manufacturer to enforce the vertical restraints?[235] Citing *United States v. General Motors*,[236] Justice Stevens argued in his *Business Electronics* dissent that proof of such coordinated activity would, in fact, be proof of a per se violation.[237] However, assuming that one is looking for evidence of a horizontal interbrand cartel, a mere showing of coordinated complaints would not be sufficient.[238] The complaining dealers, if affiliated with the same manufacturer,[239] might believe the restraints would enhance the interbrand marketability of the product and they

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even from the fact that termination came about 'in response to' complaints, could deter or penalize perfectly legitimate conduct." Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 763 (1984).

232. At a minimum, the jury would find itself trying to distinguish between "persuasion" and "coercion." This task was frequently assigned to the jury in the heyday of *Albrecht* when dealer freedom was regarded as paramount. The distinction was a blurred one, at best. Piraino, *supra* note 58, at 10. *See, e.g.*, Filco v. Amana Refrigeration, Inc., 709 F.2d 1257, 1263 (9th Cir.), *cert. dismissed*, 464 U.S. 956 (1983); Yentsch v. Texaco, Inc., 630 F.2d 46, 53 (2d Cir. 1980).

233. *See, e.g.*, Arnold Pontiac-GMC, Inc. v. General Motors Corp., 700 F. Supp. 838, 842 (W.D. Pa. 1988) (summary judgment improper because manufacturer's liability for vertical restraint will turn on jury's finding as to the manufacturer's motive).

234. *Monsanto*, 465 U.S. at 763-64; *Business Electronics*, 485 U.S. at 727-28. *See also*, Piraino, *supra* note 58, at 16-17. In his *Business Electronics* dissent, Justice Stevens was not so pessimistic about the jury's ability to discern the motive of the manufacturer: "Proof of motivation is another commonplace in antitrust litigation of which the majority appears apprehensive, but as we have explained or demonstrated many times, . . . in antitrust, as in many other areas of the law, motivation matters and factfinders are able to distinguish bad from good intent." *Business Electronics*, 485 U.S at 753-54.

235. In criminal law, courts developed the Wharton Rule for distinguishing between crimes that necessarily involve two parties (*e.g.*, adultery) and conspiracy to commit such a crime (*e.g.*, conspiracy to commit adultery). Under the Wharton Rule, while the crime of adultery only requires two actors, conspiracy to commit adultery requires three parties. R. ANDERSON, *supra* note 21, § 89, at 191-93; R. PERKINS & R. BOYCE, *supra* note 21, at 689-92. A similar approach could be used with vertical restraints. One could take the position that a showing of a two-party manufacturer-dealer communication (such as occurred in *Business Electronics*) is never sufficient to establish a section one violation, but proof of a third party's involvement (for example, a second complaining dealer) is enough to satisfy the "agreement" prong of the offense. For the reasons outlined in this Article, however, such a resolution will not likely be adopted by the Court.

236. 384 U.S. 127 (1966).

237. Justice Stevens thus chastised the majority in *Business Electronics* for what he regarded as a meaningless distinction between a manufacturer's actions in response to one complaining dealer and a manufacturer's actions in response to two or more complaining dealers. *See* Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 742, 747 (1988).

238. Although the majority of the Supreme Court in *Business Electronics* purported to distinguish *General Motors*, 485 U.S. 717, 742-43 n.5, a strong argument can be made that, under the rationale of *Business Electronics*, a purely intrabrand cartel is not illegal and therefore *General Motors* is no longer good law. Alternatively, one can argue that at the time *General Motors* was decided (1966), *General Motors* had market power that resulted in restraint on the interbrand automobile market. *See supra* note 225.

239. If the plaintiff could show that dealers of *different* manufacturers coordinated their demands for vertical restraints (or that two or more competing manufacturers coordinated the imposition of such restraints), then the plaintiff would have shown cartel-like behavior in the interbrand market and should easily get to the jury.

would therefore have a legitimate and procompetitive reason for both making their views known and coordinating their efforts.[240]

A third question suggested by Justice Stevens' dissent is: What weight, if any, will be given to evidence that the source of the vertical restraint was the dealers rather than the manufacturer? Stevens contended that such evidence should be given substantial weight (and probably should support a prima facie case) since "retailers . . . care less about the general efficiency of a product's promotion than their own profit margins."[241] However, if one assumes that dealers are interested in efficient and competitive distribution of the product,[242] there could well be instances in which the vertical restraints are suggested by dealers, not to further a cartel, but to enhance the competitiveness of the product on the interbrand market.[243]

Thus, if the line between legal and illegal vertical arrangements is drawn on the basis of whether the restraint is part of a horizontal interbrand cartel, none of this evidence—coercion, joint intrabrand dealer activity, or dealer instigation of restraints—is likely to be enough to make out a prima facie vertical case.[244] Instead, to be consistent with the rationale of *Business Electronics*, the Court will probably require the plaintiff to show some evidence of a cartel (or other anticompetitive conduct)[245] in its prima facie case. Whether the Court goes so far as to require the plaintiff to offer the same level of proof that is necessary in a horizontal case depends on whether the Court wants to retain the vertical restraint as an offense separate and distinct from the horizontal restraint.[246]

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240. *See* Liebeler, *supra* note 32, at 25; Posner, *The Next Step*, *supra* note 8, at 23-24 n.65; Posner, *Antitrust Policy*, *supra* note 2, at 298-99.

241. Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 755 (1988). Professor Areeda makes the same point. VII P. AREEDA, *supra* note 3, para. 1457 at 166-67.

242. Liebeler, *supra* note 32, at 25.

243. The Eighth Circuit recently noted:

> The distributor may have a better understanding than his supplier of which intrabrand restraints will most significantly enhance the interbrand competitiveness of the supplier's goods at the retail level. Indeed, this expertise may be one of the main reasons for the supplier's decision to employ an independent distributor rather than to integrate vertically his own distribution network.

Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc., 824 F.2d 582, 593 (8th Cir. 1987). The court further noted that distinguishing between dealer-instigated and dealer-coerced vertical restraints would "as an administrative matter" be very difficult. "[T]he trier of fact would need to distinguish between a dealer's strong suggestion and outright demand, and between a supplier's willing acceptance and grudging acquiescence." *Id.* at 594.

244. Nor is a combination of this evidence likely to suffice. Even where there is such a combination, a court might well find itself discouraging "legitimate and competitively useful conduct" by permitting the case to go to the jury. *See supra* note 231 and accompanying text.

245. *See supra* note 225.

246. Unless and until a showing of interbrand market power is required in a horizontal case (and some argue that it should be required in a horizontal case, *see supra* note 38), such a showing should not be mandated in a vertical case, to avoid the anomalous result of requiring more to prove the latter than the former. *See Business Electronics*, 485 U.S. at 744 n.7 (Stevens, J., dissenting). *See also* White, *Antitrust Enforcement: Enhancement Through A Sharpened Rule of Reason*, 20 ARIZ. ST. L.J. 749, 768 (1988).

C. *Is There Any Point In Keeping the Rule of Reason Approach for Nonprice Restraints?*

If the Supreme Court does move to a distinction between legal and illegal vertical price restraints based on the presence or absence of evidence of a horizontal cartel, the last issue to be resolved is: Should courts retain the rule of reason analysis for nonprice restraints?[247] Given the rule of reason analysis as it presently exists,[248] the answer to this question must be no.

The primary problem with retaining the rule of reason challenge for agreed-to nonprice restraints[249] is that rule of reason scrutiny looks to factors other than (and less than) facilitation of a horizontal interbrand cartel.[250] Thus, continued use of the rule of reason analysis theoretically permits condemnation of a vertical nonprice restraint on grounds that cannot be considered in evaluating the legality of a vertical price restraint.[251] As a number of commentators have noted, however, the difference in economic and market effect between vertical price and vertical nonprice restraints is slight, assuming it exists at all.[252]

Furthermore, as a practical matter, there are sizable problems with using the rule of reason analysis as it now exists. For one thing, many scholars question whether a jury can possibly do the type of balancing and analysis called for by the rule of reason.[253] In addition, given the difficulty in applying the rule of

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247. A related question is: If we do retain the rule of reason analysis for nonprice restraints, should we permit a plaintiff challenging a vertical price restraint to have the option of challenging it under the rule of reason? The answer to this question will presumably be the same as the answer for nonprice restraints.

248. For a historical review of the rule of reason, see Peritz, *The "Rule of Reason" in Antitrust Law: Property Logic In Restraint of Competition*, 40 HASTINGS L.J. 285 (1989).

249. Under *Sylvania* and *Monsanto*, vertical nonprice restraints are either legal (if there is no agreement) or illegal (if they are by agreement and fail to survive a rule of reason challenge). *See supra* notes 131-71 and accompanying text.

250. In *Sylvania* the Supreme Court suggested the trier of fact might be called on to balance "intrabrand harm and interbrand benefit[s]" of the restriction. *Sylvania*, 433 U.S. 36, 52 (1977). In earlier decisions the Court suggested an even broader range of factors to be considered. For instance, in Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918), the Court gave the following description of the rule of reason analysis:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint, . . . the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id. at 238. *See also* National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 692 (1978). Yet in *Business Electronics*, the Court specifically downplayed the relevance of harm on the intrabrand market in judging the legality of vertical price restraints. *See supra* note 183.

251. *See* the factors in *supra* note 250. A nonprice restraint could conceivably be condemned for producing an undue restraint on the intrabrand market, or for restraining trader freedom, even though the plaintiff presented no evidence that the restraint was part of a horizontal interbrand cartel. *See supra* note 223, discussing the possibility of introducing noneconomic factors in a rule of reason case.

The defendant in that rule of reason case is, of course, benefitted by being able to introduce evidence of procompetitive benefits flowing from the restraint. National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 691 (1978); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 52 (1977).

252. *See supra* note 67. The Supreme Court itself in *Business Electronics* demonstrated the difficulty in distinguishing vertical price from nonprice restraints. *See supra* note 211.

253. *See, e.g.*, Easterbrook, *Vertical Arrangements*, *supra* note 27, at 153-55; Gerhart, *The "Competitive Advantages" Explanation For Intrabrand Restraints: An Antitrust Analysis*, 1981 DUKE L.J. 417, 438-39; Piraino, *supra* note 58, at 27-28; Posner, *The Next Step*, *supra* note 8, at 14-18; Posner, *The Rule of Reason and*

reason analysis, plaintiffs almost never win these cases[254]—making retention of the rule of reason analysis effectively worthless and the possible expansion of it to price restraints utter folly.

Thus, if the Supreme Court adopts a test for legality of vertical price restraints based on evidence of horizontal cartelizing, the Court should use the same test for vertical nonprice restraints.

VII. CONCLUSION

The Supreme Court has set up an impossible situation in the area of vertical restraints. It has adopted a test for agreements that is fundamentally at odds with the very rationale that the Court has used to scrutinize vertical restraints.

The source of the current confusion can be traced back to the Court's failure to deal openly with a peculiarity of the vertical arrangement: the need to insulate from challenge some two-party vertical arrangements, even if they touch upon resale prices. Instead of directly determining which vertical arrangements to put in such a protected category, the Court early on, in *Colgate*, adopted a proxy—the unilateral action/agreement distinction—as a means of separating legal from illegal arrangements. Not only was this distinction logically untenable but, to make matters worse, the *Monsanto* Court transplanted the definition of "agreement" from the horizontal cases into the vertical arena. In doing so, the Court failed to recognize that the word "agreement" is not a Platonic ideal with fixed metes and bounds. On the contrary, in the vertical context the concept of an agreement is thoroughly intertwined with the antitrust policies to be advanced, so that one cannot be changed without changing the other.

The confusion has reached a breaking point with the Court's decision in *Business Electronics*. The Court has, to be sure, clarified one point: economic efficiency, and in particular the avoidance of horizontal interbrand cartels, is the chief (if not sole) concern of vertical restraint law. However, in defining the illegal vertical arrangement, the Court again eschewed a frontal approach in favor of still another proxy: the setting of a specific price or price level. The

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the Economic Approach: Reflections on the Sylvania *Decision*, 45 U. CHI. L. REV. 1, 14-16 (1977); White, *supra* note 246, at 756-59.

As a way of bringing order to the rule of reason analysis, some lower courts require that, as a threshold matter, the plaintiff show what the relevant market is and prove that the defendant has power in that market. *See, e.g.*, Ball Memorial Hosp. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1334-37 (7th Cir. 1986); Graphic Prods. Distrib., Inc. v. Itek Corp., 717 F.2d 1560, 1568-69 (11th Cir. 1983). Some commentators have criticized that approach. *See, e.g.*, Flynn & Ponsoldt, *supra* note 29, at 1150; White, *supra* note 246, at 759-64. *See also* Hovenkamp, *Antitrust Policy*, *supra* note 204, at 1310-18 (arguing that in applying the rule of reason test, the trier of fact should consider not only the efficiencies produced by the vertical restraint but also the extent to which the restraint raises the costs of rival firms).

For a recent attempt to describe the rule of reason test, see ABA SAMPLE JURY INSTRUCTIONS, *supra* note 12, at A-4 to A-8. *See also* Areeda, *The Rule of Reason—A Catechism On Competition*, 55 ANTITRUST L.J. 571, 571-83 (1986); Gellhorn & Tatham, *Making Sense Out of the Rule of Reason*, 35 CASE W. RES. 155, 170-81 (1985).

254. *See* Baxter, *supra* note 1, at 936; Hovenkamp, *Antitrust Policy*, *supra* note 204, at 1310; Wirtz, *supra* note 46, at 625.

result is a gap between the *Business Electronics* ruling and its rationale that will result in some vertical restraints (such as those found in the *Dr. Miles* situation) being caught in the per se illegal net even though they do not fit within the antitrust policy purportedly being furthered—prohibiting horizontal interbrand cartels. Even more troubling, the rationale espoused in *Business Electronics* is fundamentally inconsistent with what *Monsanto* states is an illegal vertical agreement. Put simply, a court will never or only rarely find the *Monsanto* agreement in the type of vertical arrangement that *Business Electronics* condemns.

The time has obviously come to clean up this morass. The proxies of "unilateral action" and "specific price" must be discarded. If the Supreme Court is serious about embracing economic efficiency as the chief or sole goal of vertical restraint law, then the Court should openly make its distinction between legal and illegal vertical restraints on that ground. The cleanest way to do so is to acknowledge that certain vertical restraints, while involving agreements and perhaps involving specific resale prices, do not constitute restraints of trade under the Sherman Act. Taking this approach, the evidentiary rulings will follow straightforwardly: merely showing coercion, concerted intrabrand dealer action, or dealer-instigated restraints will not be enough to establish a prima facie case of an illegal vertical restraint. Finally, under such an approach, the rule of reason test for nonprice restraints as it currently exists would be eliminated.

Such an approach would bring some long-needed logical consistency to the law of vertical restraints. While scholars may (and no doubt will) dispute what are or should be the goals of the antitrust laws, no one can question the need for a definition of a vertical "agreement" that is consistent with those goals.