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Mark Anderson
University of Idaho College of Law, markand@uidaho.edu

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VERTICAL AGREEMENTS UNDER SECTION 1 OF THE SHERMAN ACT: RESULTS IN SEARCH OF REASONS

MARK D. ANDERSON*

The application of section 1 of the Sherman Act[1] to resale restrictions imposed by a supplier of goods requires an analysis of whether such restrictions result from an agreement and, if so, the standard applicable to the restriction. Each of these issues is a source of continuing controversy. The present position of the United States Supreme Court on the agreement issue[2] is a product of two inappropriate influences. First, the Court has attempted to accommodate disparate interests reflected in the debate over the standards that should be applied once an agreement is proven. Second, the Court has resurrected the *Colgate*[3] doctrine, that was uncertain at its inception and has since been subject to limitation and qualification. This paper argues that the agreement issue should be resolved in light of the reason for the agreement requirement. Such a resolution requires substantial amendment of the Supreme Court's present position. This paper adopts a test to determine the existence of an agreement under section 1 of the Sherman Act and an analysis follows that demonstrates its validity.

I. THE PROBLEM

A. *The Legal Context*

Section 1 of the Sherman Act prohibits "every contract, combination . . . or conspiracy, in restraint of trade."[4] A practice violates section 1 if it (1) is a contract, combination or conspiracy,[5] and (2) restrains trade. Unilateral conduct, no matter how anticompetitive, does not violate section 1.[6] Similarly,

* Associate Professor of Law, University of Idaho. B.A. 1973, Macalester College; J.D. 1977, University of Chicago.

1. 15 U.S.C. § 1 (1982).
2. *See* Monsanto Co. v. Spray-Rite Serv. Corp., 104 S. Ct. 1464, 1469-71 (1984).
3. United States v. Colgate Co., 250 U.S. 300 (1919).
4. 15 U.S.C. § 1 (1982).
5. Different meanings may be given to each of the three words "contract," "combination" and "conspiracy" for purposes of § 1. *See* Albrecht v. Herald Co., 390 U.S. 145, 149 (1968). For purposes of this paper, however, these three terms together with the words "agreement" and "concerted" action, conduct or behavior will be treated as synonymous.
6. Unilateral conduct may violate the prohibition against actual or attempted monopolization contained in § 2 of the Sherman Act, 15 U.S.C. § 2 (1982), or may constitute a tort under state or federal unfair competition law.

concerted behavior does not violate section 1 unless it restrains trade within the meaning of the Act.[7]

In determining whether concerted behavior is sufficiently anticompetitive to be illegal under section 1, courts apply a two-tiered analysis. Courts generally apply the "rule of reason" standard under which an assessment is made of the procompetitive and anticompetitive aspects of the challenged practice.[8] Some practices, however, are considered so likely to injure competition that they are illegal per se.[9] Practices the courts have characterized as per se illegal include price fixing by competitors,[10] price fixing by a supplier and a distributor,[11] market allocations by competitors,[12] boycotts by competitors,[13] and tying arrangements.[14] To establish a per se violation, the plaintiff need only prove that the practice occurred. He is not required to show the practice was anticompetitive in the particular context.[15] Indeed, the defendant may not defend the practice by showing the practice was competitively neutral or even procompetitive.[16] The courts developed per se rules to avoid the time consuming inquiry into competitive effects otherwise required by the rule of reason.[17] In adopting

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7. The literal language of § 1 condemns every agreement which restrains trade. However, the Supreme Court has recognized that whether an agreement illegally restrains trade is a matter of degree.

> [T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. 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.

Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918); *see also* Standard Oil Co v. United States, 221 U.S. 1 (1911).

8. *See* National Soc'y of Prof. Eng'rs v. United States, 435 U.S. 679, 687-92 (1978); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918).

9. *See* Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958) ("[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.").

10. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

11. Albrecht v. Herald Co., 390 U.S. 145, 151 (1968).

12. United States v. Topco Assocs., 405 U.S. 596, 608 (1972).

13. Klor's, Inc. v. Broadway Hale Stores, Inc., 359 U.S. 207, 212 (1959).

14. Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 104 S. Ct. 1551, 1556 (1984).

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

16. *See* Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 351 (1982). The Court stated:

> The respondents' principal argument is that the *per se* rule is inapplicable because their agreements are alleged to have procompetitive justifications. The argument indicates a misunderstanding of the *per se* concept. The anticompetitive potential inherent in all price-fixing agreements justifies their facial invalidation even if procompetitive justifications are offered for some. Those claims of enhanced competition are so unlikely to prove significant in any particular case that we adhere to the rule of law that is justified in its general application.

Id. (footnote omitted).

17. *See* Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). The Court stated:

> This principle of *per se* unreasonableness not only makes the type of restraints which are

per se rules, courts acknowledge that occasionally these rules will condemn conduct which is not anticompetitive in the specific circumstances.[18] Courts regard such erroneous results that arise from applying per se rules as the price paid for saving the resources of courts, litigants, and persons planning business behavior.[19] Thus, the two elements of a violation of section 1 are: (1) an agreement (2) that unreasonably restrains trade.[20] Absent either of these two elements, section 1 has not been violated.

B. *Vertical Restrictions on Distribution: Per Se or Rule of Reason?*

Some of the most controversial issues raised by section 1 are created by its application to vertical restrictions on distribution.[21] A vertical restriction on distribution occurs when a distributor agrees with a supplier[22] to abide by restrictions in reselling the product purchased[23] from the supplier. Vertical restrictions can be divided into two categories: those affecting the price at which the distributor resells, referred to as resale price maintenance (RPM), and those affecting where or to whom the distributor resells, referred to as nonprice vertical

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> proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable - an inquiry so often wholly fruitless when undertaken.

Id.; see also Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 343-44 (1982). "The elaborate inquiry into the reasonableness of a challenged business practice entails significant costs. Litigation of the effect or purpose of a practice often is extensive and complex . . . . The costs of judging business practices under the rule of reason, however, have been reduced by the recognition of *per se* rules." *Id.*

18. *See* Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 344 (1982) ("As in every rule of general application, the match between the presumed and the actual is imperfect."); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 50 n.16 (1977) ("Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them.").

19. *See* Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 344 (1982) ("For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a fullblown inquiry might have proved to be reasonable."); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 50 n.16 (1977) ("Once established, *per se* rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule-of-reason trials. . .").

20. The unreasonableness of the agreement may be established by the application of a *per se* rule.

21. An agreement is vertical if it is between parties at different levels in the distribution chain, e.g., a manufacturer and a wholesaler or a wholesaler and a retailer. An agreement is horizontal if it is between competitors. An agreement may have both vertical and horizontal aspects, e.g., an agreement among two wholesalers and their mutual supplier that the supplier will refuse to deal with a third wholesaler.

22. This article assumes a two-level distribution chain in which a supplier sells to distributors. A distribution chain could have many levels, e.g., manufacturers, wholesalers, jobbers, subjobbers, and retailers. The analysis contained in this article would not be significantly altered for a distribution chain with more than two levels.

23. The word "purchased" is not used in a sense requiring passage of title. Much of the discussion set forth herein is also applicable to consignment transactions.

restrictions. The controversy over vertical restrictions on distribution involves both the standards for determining whether an agreement is present[24] and whether a per se rule or the rule of reason applies.[25]

1. Initial Per Se Rules

The standard for judging vertical restrictions on distribution has aroused great scholarly debate.[26] Without the benefit of this commentary, the Supreme Court addressed the issue over seventy-four years ago in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[27] The plaintiff, Dr. Miles, alleged that the defendant had induced the plaintiff's wholesalers and retailers to breach their contracts with the plaintiff. These contracts required the wholesalers and retailers to resell only at prices fixed by Dr. Miles.[28] The defendant argued that the RPM agreements were void, and therefore inducing their breach was not an actionable wrong.[29] The Court observed that Dr. Miles' RPM agreements restricted the freedom of an owner to dispose of his property.[30] After noting that "a general restraint upon alienation is ordinarily invalid,"[31] the Court stated that restraints of trade must be reasonable for both the public and the contracting parties.[32] In the Court's view, Dr. Miles' RPM restrictions on the dealer's freedom did not pass the test of reasonableness. The Court additionally condemned the agreements because, in its view, they were indistinguishable from horizontal price fixing among the wholesalers or retailers.[33] The Court held that because a price-fixing distributor cartel would be illegal, a vertical agreement which required the distributor to maintain price should also be illegal.

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24. *See infra* text accompanying notes 80-116.
25. *See infra* text accompanying notes 26-79.
26. *See infra* text accompanying notes 51-63.
27. 220 U.S. 373 (1911).
28. *Id.* at 394.
29. *Id.* at 395.
30. The Court characterized the agreements as "restricting the freedom of trade on the part of dealers who own what they sell." *Id.* at 407-08.
31. *Id.* at 404.
32. *Id.* at 406.

> With respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions. But the public interest is still the first consideration. To sustain the restraint, it must be found to be reasonable both with respect to the public and to the parties and that it is limited to what is fairly necessary, in the circumstances of the particular case, for the protection of the covenantee. Otherwise restraints of trade are void as against public policy.

Id.

33. *Id.* at 407-08.

> [T]he advantage of established retail prices primarily concerns the dealers. The enlarged profits which would result from adherence to the established rates would go to them and not to the complainant . . . . As to this, the complainant 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. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit to the complainant cannot be regarded as sufficient to support its system.

Assuming the existence of an agreement, RPM has been per se illegal since *Dr. Miles*.[34] However, both of the justifications asserted in the *Dr. Miles* decision have been rejected. The Court has rejected the argument that a concern about restraints on alienation requires condemnation of vertical restrictions on distribution.[35] Further, the identity of RPM and distributor cartels has been called into serious question.[36]

While the per se illegality of RPM has remained constant since *Dr. Miles*,[37] the standard for judging nonprice vertical restrictions has gone through dramatic changes. In *White Motor Co. v. United States*, the Court refused to hold that nonprice vertical restrictions were per se illegal.[38] Four years later, however, the Court imposed a per se standard on such restrictions. In *United States v. Arnold, Schwinn & Co.*,[39] the government challenged a series of nonprice vertical restrictions imposed by a bicycle manufacturer on its wholesalers and retailers. Schwinn sold its bicycles through twenty-two wholesale distributors and approximately 5,500 retail dealers. Schwinn required its wholesale distributors to limit their sales to exclusive territories and to sell only to approved retailers.[40] Schwinn further required its retailers to sell only to consumers rather than to other unapproved retailers.[41] These restrictions aided in maintaining the bicycle manufacturer's rigid marketing scheme. Schwinn sold its bicycles by three methods: (1) sales to distributors for resale to retailers; (2) sales to retailers through a consignment to distributors; and (3) sales to retailers by the Schwinn Plan under which the distributor acted as a commission sales agent for Schwinn but never obtained possession of the bicycles.[42] Thus, in a sale for resale, the wholesaler took both possession of and title to the bicycles. In a consignment transaction, the wholesaler took possession but not title. Under the "Schwinn Plan" the wholesaler merely solicited orders and did not take either possession or title.

The district court held that Schwinn's confinement of its wholesale distributors to assigned territories was per se illegal in the sale for resale transactions.[43] The court, however, refused to enjoin (1) the confinement of wholesalers to

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> 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. They are not saved by the advantages which the participants expect to derive from the enhanced price to the customer.

Id. Such a horizontal price fixing agreement would be per se illegal. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

34. *See* ABA ANTITRUST SECTION, 1984 ANTITRUST LAW DEVELOPMENTS (SECOND) 56 [hereinafter cited as DEVELOPMENTS].

35. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 53 n.21; *infra* note 78 and accompanying text.

36. *See infra* text accompanying notes 51-63.

37. *See supra* text accompanying note 34.

38. 372 U.S. 253, 263 (1963).

39. 388 U.S. 365 (1967), *overruled*, Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58 (1977).

40. 388 U.S. at 371.

41. *Id.*

42. *Id.* at 370.

43. *Id.* at 376.

assigned territories in consignment or Schwinn Plan transactions; (2) the confinement of wholesalers to sales to retailers approved by Schwinn; or, (3) the confinement of retailers to sales to consumers.[44] Schwinn did not appeal the district court's judgment of per se illegality for its territorial restrictions on wholesalers in sales for resale.[45] The government did appeal the court's refusal to enjoin the other three territorial and customer restrictions,[46] although it did not assert that those restrictions were per se illegal.[47]

The Supreme Court held that nonprice vertical restrictions on distribution are per se illegal when imposed on a sale for resale. The rule of reason, however, applies when the restrictions are imposed in a consignment or agency setting.[48] The Court reasoned that in the former situation the manufacturer parted with dominion over an article and thus under section 1 of the Sherman Act it could not restrict or confine areas where the article could be traded without a per se violation. In the latter consignment or agency setting, however, the Court reasoned that because the manufacturer retained dominion over the article, restrictions could be imposed, as long as they were reasonable.[49] The Court explained that allowing a supplier to impose customer or territorial restrictions

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44. *Id.* at 376-77.

45. *Id.* at 368.

46. *Id.* at 377.

47. *Id.* at 368. In this regard, it is interesting to note that Judge Posner argued the case for the United States. *Id.* at 366. As will be seen, Judge Posner is one of the most prominent advocates of abolition of per se treatment of vertical restrictions on distribution. *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 147-66 (1976).

48. This required that the district court be directed to amend its decree to enjoin both territorial and customer restrictions on wholesalers in sales for resale transactions and to enjoin the customer restrictions on retailers (who only obtained bicycles in sale for resale transactions). 388 U.S. at 377-78. The Supreme Court's holding also required that the rule of reason be applied to the territorial and customer restrictions on wholesalers in consignment and Schwinn Plan transactions. The Court made this application and found the practices lawful. *Id.* at 380-81.

49. *Id.* at 378-80.

> We conclude that the proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer parts with the title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss.
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> As the District Court held, where a manufacturer *sells* products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results. And, as we have held, the same principle applies to restrictions of outlets with which the distributors may deal and to restraints upon retailers to whom the goods are sold. Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. . . .
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> The Government does not here contend for a *per se* rule as to agency, consignment, or Schwinn-Plan transactions even though these may be used — as they are here — to implement a scheme of confining distribution outlets as in this case. Where the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer, it is only if the impact of the confinement is "unreasonably" restrictive of competition that a violation of § 1 results from such confinement, unencumbered by culpable price fixing.

Id.

in a sale for resale transaction "would violate the ancient rule against restraints on alienation."[50]

Thus, by 1967, RPM was illegal per se and nonprice vertical restrictions were per se illegal unless accomplished through consignment or agency transactions. Although the cases establishing these rules were not supported by powerful arguments based on uncontroverted economic analysis, they were generally consistent. A storm of scholarly criticism and debate was, however, on the horizon, and the consistency was soon disrupted.

2. Economic Arguments in Favor of Vertical Restrictions on Distribution.

Although *Dr. Miles* and *Schwinn* established uniform rules of per se illegality for RPM and nonprice vertical restrictions, these rules were not quietly accepted. The standards applicable to vertical restrictions have aroused a vast amount of commentary.[51] Commentators have debated whether vertical restrictions on distribution are so anticompetitive that per se treatment is warranted. If a scenario in which such restrictions have procompetitive effects is sufficiently common, a per se standard is inappropriate.

RPM may have anticompetitive effects.[52] The supplier may form a cartel with specific distributors. The supplier may then enforce RPM to prevent member distributors from cheating on the price fixed by the group.[53] Similarly, RPM may aid a cartel of suppliers by reducing the incentive for its members to cheat.[54] Without RPM, a member of a supplier cartel may be tempted to cheat by lowering its prices to distributors who may in turn lower prices to consumers thereby increasing sales.[55] These price reductions to distributors may

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50. *Id.* at 380. This idea echoes one of the Court's reasons for prohibiting RPM in *Dr. Miles*. *See supra* text accompanying notes 30-32.

51. *See, e.g.*, R. BORK, THE ANTITRUST PARADOX 280-98 (1978); H. HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW 247-72 (1985); R. POSNER, *supra* note 47, at 147-66; Anderson, *The Antitrust Consequences of Manufacturer-Suggested Retail Prices — The Case for Presumptive Illegality*, 54 WASH. L. REV. 763 (1979); Baxter, *Vertical Practices — Half Slave, Half Free*, 52 ANTITRUST L.J. 743 (1983); Calvani & Berg, *Resale Price Maintenance after* Monsanto: *A Doctrine Still at War With Itself*, 1984 DUKE L.J. 1163; Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135 (1984); Halverson, *An Overview of Legal and Economic Issues and the Relevance of the Vertical Merger Guidelines*, 52 ANTITRUST L.J. 49 (1983); Hay, *Vertical Restraints After* Monsanto, 70 CORNELL L. REV. 418 (1985); Popofsky, *Lawyer's Response*, 52 ANTITRUST L.J. 719 (1983); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1 (1977); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competitor Decisions*, 75 COLUM. L. REV. 282 (1975) [hereinafter cited as Posner, *Restricted Distribution*]; Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 687 (1983).

52. The discussion in the text will focus on RPM. The arguments in favor of vertical restrictions on distribution have largely been accepted as applied to nonprice vertical restrictions. *See infra* text accompanying notes 64-79. Thus, the continuing controversy relates to their application to RPM.

53. *See, e.g.*, R. POSNER, *supra* note 47, at 148. There is some doubt whether a rational supplier would become involved in such a scheme. *See, e.g.*, H. HOVENKAMP, *supra* note 51, at 250-52.

54. *See* Halverson, *supra* note 51, at 64-67.

55. *Id.* at 65.

be difficult for other members of the supplier cartel to detect because wholesale prices are often not made public. However, if in addition to fixing the price to the distributor the cartel members also agree to impose RPM and fix the retail price, the incentive to cheat is reduced. Resale prices may be publicly available and therefore easier for other cartel members to monitor. A member of the supplier cartel cannot easily cheat by lowering its price to distributors and allowing its distributors, in turn, to reduce the resale price fixed by the cartel. If the resale price cannot be lowered to increase the quantity demanded by consumers, the supplier has less incentive to reduce its price to the distributor.

The possibility that RPM may aid cartels, either at the distributor or the supplier level, might be sufficient alone to condemn it as a per se violation provided that RPM was chiefly used to aid cartels.[56] However, opponents of per se illegality for RPM argue that RPM is often imposed by a supplier for procompetitive reasons unrelated to the existence of a cartel. If that is true, per se treatment is inappropriate. Thus the debate over application of the per se rule to RPM turns upon the reasons for imposing RPM.

As a threshold matter two things are clear. First, the supplier would not use RPM as a means of attaining an optimal combination of price and quantity. If the supplier wished to restrict its output and raise prices it could do so without RPM by simply producing less and raising its price to distributors.[57] Second, the supplier would not use RPM to increase the spread between its price to distributors and the distributors' resale price merely to put money in the distributors' pockets. The supplier has no reason to give away money to its distributors.[58] Nevertheless a supplier may claim that RPM fosters competition.

Proponents of RPM offer a paradoxical explanation of the procompetitive function of RPM. They assert that the supplier increases the resale price of its products to increase the quantity of the product demanded by consumers. This seems paradoxical because, ordinarily, a higher resale price would reduce the quantity demanded by consumers.[59] Thus, common sense would suggest that at any given wholesale price a supplier would like its distributors to charge as little as possible to increase the quantity demanded by consumers.[60] By imposing RPM, however, the supplier is increasing rather than reducing resale prices and would seem to be irrationally causing a reduction in quantity demanded.[61]

Proponents of RPM argue that the supplier must be counting on some other effect of RPM to increase demand. They suggest that a greater margin between

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56. Regardless of the standard applicable to RPM, the underlying cartel is illegal per se. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

57. *See* R. BORK, *supra* note 51, at 290.

58. *Id.*

59. *See* R. POSNER, *supra* note 47, at 147.

60. *Id.* at 147-48.

61. It may be rational for a supplier to cause a reduction in quantity demanded by increasing its price to its distributors. The reduction in output might be offset by the increase in price received by the supplier. However, causing a reduction in quantity demanded by using RPM would be irrational because the supplier would not receive any increase in its price to the distributor.

the cost of the product and resale price induces distributors to provide promotional service for the product. Proponents theorize that if RPM causes the distributors' margin on the supplier's product to exceed the cost associated with the usual distribution practices, distributors will engage in promotional activities to sell more of the supplier's product. Because promotional activities increase costs, distributors must decide what quantity of such activities to supply. They will continue to engage in these activities until their costs equal the margin provided by the supplier's RPM. If the supplier has guessed correctly in setting the resale price, the demand-enhancing effects of the distributors' promotional activities will offset the demand-diminishing effects of the increased resale price. As a result, the quantity demanded by consumers will exceed that which would exist without RPM.[62]

Proponents of RPM explain why RPM is necessary to induce the optimal level of promotional services by introducing the "free rider problem." Simply stated, the free rider problem occurs when some distributors provide product promotion services while others do not. In the extreme, the "no-frills" distributor may charge a lower price for the goods because his costs are lower than those of the promoting distributor. The promoting distributor has higher costs caused by the promotional services, such as providing an elaborate showroom or a sophisticated service department. The free riding occurs, for example, when the buyer selects a model by visiting the promoting distributor's store but purchases it from the non-promoting distributor.[63]

The proponents of RPM argue that, because of the free rider problem, RPM is necessary to induce the promotional services that consumers desire. Therefore, a supplier using RPM is not necessarily part of a distributor or supplier cartel, but rather may be merely trying to efficiently fulfill consumer desires. If such a procompetitive scenario is sufficiently probable, per se illegality would be inappropriate. Presumably the possibility that RPM would be used to assist a supplier or distributor cartel could be addressed by a combination of the per se rule against cartels and analysis of RPM under the rule of reason.

62. *See generally* H. HOVENKAMP, *supra* note 51, at 254-55; Posner, *Restricted Distribution*, *supra* note 51, at 283-84.

63. R. POSNER *supra* note 47, at 149.

> The reader may be wondering, however, why, if the consumer demands such services, the retailers do not provide them without prompting and raise their prices to cover the higher costs of distribution. The reason is that some retailers will prefer to provide no services and instead take a "free ride" on those retailers who do. Let dealer A provide the elaborate showroom, demonstration, and other services that consumers demand and raise his price to cover the cost of the services. Dealer B, rather than provide any services, can suggest to his customers that they first utilize A's services to pick the model they want and then return to B for the purchase. B can offer a lower price than A since he does not incur the expenses that A incurs in providing services. Faced with B's lower-priced competition, A will eventually stop providing services (or provide fewer of them), and the manufacturer's desire for point-of-sale services will be frustrated. Although the free riding problem could be eliminated by A's charging separately for point-of-sale services, it should be obvious why the manufacturer might not consider an admission fee to a dealer's showroom a satisfactory alternative to a minimum retail price, which eliminates the incentive for free riding by preventing B from undercutting A.

Id.

3. Economic Arguments in Favor of Vertical Restrictions on Distribution Are Accepted For Nonprice Restrictions

In *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[64] the Court addressed the standard for judging nonprice vertical restraints in light of the modern scholarship.[65] Sylvania manufactured television sets for sale directly to retail dealers.[66] Sylvania allowed its dealers to resell its products only from locations specified by Sylvania.[67] Continental, a Sylvania dealer, began selling Sylvania products at a location not approved by Sylvania. After this violation of the location requirement and deterioration in their credit relationship, Sylvania terminated Continental's dealership.[68] In response to a collection action brought by Sylvania, Continental challenged the legality of Sylvania's location restrictions under section 1.[69] Thus, if the restrictions were to be upheld, the per se rule announced in the *Schwinn* case would have to be overruled. The Court noted that many scholars [70] criticized *Schwinn* and that lower courts limited its holding.[71] The Court then proceeded to measure its per se rule against the traditional standards for such rules.

To determine whether nonprice vertical restrictions have a "pernicious effect on competition and lack . . . any redeeming virtue,"[72] the Court turned to an analysis of their potential for benefit and detriment to competition. While ac-

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64. 433 U.S. 36 (1977).
65. *See supra* text accompanying notes 51-63.
66. 433 U.S. at 38.
67. *Id.*
68. *Id.* at 40.
69. *Id.* at 45-46. The Court declined to distinguish the Sylvania location restriction from the restraints involved in *Schwinn* stating that the differences were "irrelevent to functional antitrust analysis and, indeed, to the language and broad thrust of the opinion in *Schwinn*." *Id.* at 46.
70. *Id.* at 48 n.13.

> A former Assistant Attorney General in charge of the Antitrust Division has described *Schwinn* as an "exercise in barren formalism" that is "artificial and unresponsive to the competitive needs of the real world." Baker, Vertical Restraints in Times of Change: From *White* to *Schwinn* to Where?, 44 Antitrust L.J. 537 (1975). See, *e.g.*, Handler, The Twentieth Annual Antitrust Review-1967, 53 Va. L. Rev. 1667 (1967); McLaren, Territorial Customer Restrictions, Consignments, Suggested Retail Prices and Refusals to Deal, 37 Antitrust L.J. 137 (1968); Pollock, Alternative Distribution Methods After *Schwinn*, 63 Nw. U.L. Rev. 595 (1968); Posner, Antitrust Policy and the Supreme Court An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum. L. Rev. 282 (1975); Robinson, Recent Antitrust Developments: 1974, 75 Colum L. Rev. 244 (1975); Note, Vertical Territorial and Customer Restrictions in the Franchising Industry, 10 Colum. J.L. & Soc. Prob. 497 (1974); Note, Territorial and Customer Restrictions: A Trend Toward a Broader Rule of Reason?, 40 Geo. Wash. L. Rev. 123 (1971); Note, Territorial Restrictions and Per Se Rules-A Re-evaluation of the *Schwinn* and *Sealy* Doctrines, 70 Mich. L. Rev. 616 (1972). But see Louis, Vertical Distributional Restraints Under *Schwinn* and *Sylvania*: An Argument for the Continuing Use of a Partial Per Se Approach, 75 Mich. L. Rev. 275 (1976); Zimmerman, Distribution Restrictions After *Sealy* and *Schwinn*, 12 Antitrust Bull. 1181 (1967). For a more inclusive list of articles and comments, see 537 F.2d at 988 n. 13.

Id.

71. *Id.* at 48 n.14.
72. Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

knowledging that such restrictions reduce intrabrand competition,[73] the Court recognized that they also have a potential for increasing interbrand competition. In doing so, the Court focused on the distributional efficiency and free rider arguments discussed above.[74]

Because of the potential for procompetitive effects, the *Sylvania* Court overruled the per se rule established in *Schwinn* and held that nonprice vertical restrictions should be governed by the rule of reason.[75] The Court rejected the distinction made in the *Schwinn* decision between sales for resale and consignment transactions.[76] Instead it concluded that the form of the transaction did not alter the economic effect of the restriction.[77] The Court expressly rejected the *Schwinn* Court's concern about restraints on alienation as a reason for prohibiting vertical restrictions.[78] Although the *Sylvania* Court accepted the argu-

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73. Vertical restrictions reduce intraband competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers. Location restrictions have this effect because of practical constraints on the effective marketing area of retail outlets. Although intrabrand competition may be reduced, the ability of retailers to exploit the resulting market may be limited both by the ability of consumers to travel to other franchised locations and, perhaps more importantly, to purchase the competing product of other manufacturers.

433 U.S. at 54.

74. *Id.* at 54-55.

Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These "redeeming virtues" are implicit in every decision sustaining vertical restrictions under the rule of reason. Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. See, e.g., Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 Law & Contemp. Prob. 506, 511 (1965). For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product. Because of market imperfections such as the so-called "free rider" effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.

Id. (footnote and citations omitted); *see also supra* text accompanying notes 51-63.

75. 433 U.S. at 58.

76. *Id.* at 57.

77. "Nor is there even an assertion in the [*Schwinn*] opinion that the competitive impact of vertical restrictions is significantly affected by the form of the transaction." *Id.* at 54.

78. The Court [in *Schwinn*] also stated that to impose vertical restrictions in sale transactions would "violate the ancient rule against restraints on alienation." 388 U.S. at 380. This isolated reference has provoked sharp criticism from virtually all of the commentators on the decision, most of whom have regarded the Court's apparent reliance on the "ancient rule" as both a misreading of legal history and a perversion of antitrust analysis. We quite agree with MR. JUSTICE STEWART's dissenting comment in *Schwinn* that "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." 388 U.S. at 392.

ments favoring vertical restrictions, its holding is limited to nonprice restrictions. In dicta, the Court expressly rejected using those same arguments to overturn the per se rule against RPM.[79]

After *Sylvania*, nonprice vertical restrictions are subject to the rule of reason, and RPM is per se illegal. This distinction creates tension over the standards applicable to two similar types of restrictions. It also may impact the standards for determining whether the necessary agreement exists that gives rise to an alleged vertical restriction.

C. *Agreement Issues in Vertical Contexts*

A vertical practice is unlawful under section 1 only if it results from an agreement.[80] Thus, the standard for determining whether an agreement is present can be crucial. This issue is especially important with respect to RPM, because if an agreement is proved, the conduct is per se illegal.[81] This section will set forth two common scenarios that give rise to vertical agreement issues. In the supplier-initiated scenario, the issue is whether a supplier's conduct followed by a distributor's response creates an inference of an agreement. The

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Id. at 53 n.21 (citations omitted). The Court also rejected the same argument phrased as a concern about the autonomy of traders.

> We are similarly unable to accept Judge Browning's interpretation of *Schwinn*. In his dissent below he argued that the decision reflects the view that the Sherman Act was intended to prohibit restrictions on the autonomy of independent businessmen even though they have no impact on "price, quality, and quantity of goods and services," 537 F.2d, at 1019. This view is certainly not explicit in *Schwinn*, which purports to be based on an examination of the "impact [of the restrictions] upon the marketplace." 388 U.S., at 374. Competitive economies have social and political as well as economic advantages, . . . but an antitrust policy divorced from market considerations would lack any objective benchmarks. As Mr. Justice Brandeis reminded us: "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. at 238.

Id. (citation omitted).

79. As in *Schwinn*, we are concerned here only with nonprice vertical restrictions. The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As MR. JUSTICE WHITE notes, . . . some commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in *White Motor Co. v. United States*, MR. JUSTICE BRENNAN noted that, unlike nonprice restrictions, "[r]esale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands." 372 U.S., at 268. Professor Posner also recognized that "industry-wide resale price maintenance might facilitate cartelizing.". . . Furthermore, Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States. Consumer Goods Pricing Act of 1975, 89 Stat. 801, amending 15 U.S.C. §§ 1, 45(a). No similar expression of congressional intent exists for nonprice restrictions.

Id. at 51 n.18 (citations omitted); *see also* Posner, *Restricted Distribution*, *supra* note 51, at 294.

80. *See supra* text accompanying notes 4-6.

81. Albrecht v. Herald Co., 390 U.S. 145, 151 (1968).

distributor-initiated scenario also raises the agreement issue, but begins with distributor conduct followed by supplier response.

1. The Supplier-Initiated Scenario — The *Colgate* Doctrine

The required agreement is obviously present in some supplier-initiated scenarios. For example, in *Dr. Miles* the supplier made the distributor enter into contracts to maintain certain prices.[82] However, in the absence of express contracts, the trier of fact must determine whether the supplier and the distributor have agreed that the distributor will abide by restrictions on resale.[83] Resolving this issue, a sufficiently difficult task on its face, was made even more formidable by the decision in *United States v. Colgate & Co.*[84]

In *Colgate*, the government charged that Colgate violated the rule against RPM established in *Dr. Miles*.[85] The indictment charged that Colgate engaged in conduct[86] which caused its wholesalers and retailers to maintain resale prices.[87]

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82. *See supra* text accompanying notes 27-29.

83. 15 U.S.C. § 1 (1982).

84. 250 U.S. 300 (1919).

85. *Id.* at 302-03. The indictment read in part as follows:

"During the aforesaid period of time, within the said eastern district of Virginia and throughout the United States, the defendant knowingly and unlawfully created and engaged in a combination with said wholesale and retail dealers, in the eastern district of Virginia and throughout the United States, for the purpose and with the effect of procuring adherence on the part of such dealers (in reselling such products sold to them as aforesaid) to resale prices fixed by the defendant, and of preventing such dealers from reselling such products at lower prices, thus supressing competition amongst such wholesale dealers, and amongst such retail dealers, in restraint of the aforesaid trade and commerce among the several States, in violation of the act entitled 'An Act to protect trade and commerce against unlawful restraints and monopolies,' approved July 2, 1890."

Id.

86. *Id.* at 303.

[The indictment contains] a summary of things done to carry out the purposes of the combination: Distribution among dealers of letters, telegrams, circulars, and lists showing uniform prices to be charged; urging them to adhere to such prices and notices, stating that no sales would be made to those who did not; requests, often complied with, for information concerning dealers who had departed from specified prices; investigation and discovery of those not adhering thereto and placing their names upon "suspended lists"; requests to offending dealers for assurances and promises of future adherence to prices, which were often given; uniform refusals to sell to any who failed to give the same; sales to those who did; similar assurances and promises required of, and given by, other dealers followed by sales to them; unrestricted sales to dealers with established accounts who had observed specified prices, etc.

Id.

87. The indictment summarized this effect as follows:

"By reason of the foregoing, wholesale dealers in the aforesaid products of the defendant in the eastern district of Virginia and throughout the United States, with few exceptions, resold, at uniform prices fixed by the defendant, and refused to resell such products at lower prices to retail dealers in the States where the respective wholesale dealers did business and in other States. For the same reason retail dealers in the aforesaid products of the defendant in the eastern district of Virginia and throughout the United States resold, at uniform prices fixed by the defendant, the aforesaid products, sold to them by the defendant and by the aforesaid wholesale dealers, and refused to sell such products at lower prices

Despite the government's allegations, the trial court dismissed the indictment, holding that it did not charge a violation of section 1.[88]

On appeal, the Supreme Court stated that it was bound by the trial court's interpretation of the indictment.[89] This determination led the Court to forsake the indictment and search for the trial court's interpretation. Part of the trial court's opinion seemed to indicate it viewed the indictment as charging a combination and agreement to maintain resale prices.[90] The government argued that this language supported application of the *Dr. Miles* rule. The Supreme Court, however, focused on other portions of the trial court opinion and upheld the dismissal.[91] The Court went on to state what has come to be known as the "*Colgate* doctrine":

> In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own in-

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to the consuming public in the States where the respective retail dealers did business and in other States. Thus competition in the sale of such products, by wholesale dealers to retail dealers, and by retail dealers to the consuming public, was suppressed, and the prices of such products to the retail dealers and to the consuming public in the eastern district of Virginia and throughout the United States were maintained and enhanced."

Id. at 303-04.

88. *Id.* at 302.

89. *Id.* at 301-02.

90. *Id.* at 304-05.

In the course of its opinion, the trial court said:

"No charge is made that any contract was entered into by and on the part of the defendant, and any of its retail customers, in restraint of interstate trade and commerce — the averment being, in effect, that it knowingly and unlawfully created and engaged in a combination with certain of its wholesale and retail customers, to procure adherence on their part, in the sale of its products sold to them, to resale prices fixed by the defendant, and that, in connection therewith, such wholesale and retail customers gave assurances and promises, which resulted in the enhancement and maintenance of such prices, and in the suppression of competition by wholesale dealers and retail dealers, and by the latter to the consuming public.

"In the view taken by the court, the indictment here fairly presents the question of whether a manufacturer of products shipped in interstate trade, is subject to criminal prosecution under the Sherman Act, for entering into a combination in restraint of such trade and commerce, because he agrees with his wholesale and retail customers, upon prices claimed by them to be fair and reasonable, at which the same may be resold, and declines to sell his products to those who will not thus stipulate as to prices."

Id.

91. *Id.* at 306-07.

Considering all said in the opinion (notwithstanding some serious doubts) we are unable to accept the construction placed upon it by the Government. We cannot, e.g., wholly disregard the statement that "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." And we must conclude that, as interpreted below, the indictment does not charge Colgate & Company with selling its products to dealers under agreements which obligated the latter not to resell except at prices fixed by the company.

Id.

> dependent 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.[92]

The Court seemed to say that a supplier may lawfully coerce its distributors into complying with its desired resale prices by announcing and following a policy of refusing to deal with distributors who do not comply. Apparently, the required agreement would be absent.[93] Thus, under *Colgate*, coerced compliance with RPM would be per se lawful because no express agreement or contract exists.

Limiting application of the per se rule against RPM to formal contracts might be plausible if the rule was only based on concerns about restraints upon alienation.[94] The *Dr. Miles* Court, however, relied upon an analogy to dealer cartels in addition to a concern about restraints on alienation.[95] Therefore, requiring a formal contract before finding a violation of section 1 is inappropriate.[96] If the concept of "contract, combination . . . or conspiracy" includes more than formal contracts, *Colgate*'s apparent holding that no agreement was present is difficult to square with the trial court's interpretation of the indictment allegations regarding assurance and promises of adherence to resale prices.[97]

Not surprisingly, the *Colgate* doctrine proved unstable. By the time the Court had decided *United States v. Parke, Davis & Co.*,[98] the doctrine appeared to have little practical application. The government sought to enjoin practices by Parke, Davis that the government argued violated the per se rule against RPM.[99] The trial court held that the *Colgate* doctrine protected Parke, Davis' conduct.[100] The Supreme Court reversed, holding that the defendant's conduct did not fall within the doctrine.[101]

Parke, Davis sold its pharmaceutical products both to wholesalers and directly to retailers.[102] To maintain resale prices the pharmaceutical company: (1) announced a policy of refusing to sell to wholesalers who did not follow its wholesale resale price schedule or who sold to retailers who did not follow its retail resale price schedule;[103] and (2) informed retailers that neither it nor its wholesalers would sell to retailers who failed to follow its retail resale price

92. *Id.* at 307.

93. However, for an argument that the *Colgate* doctrine assumes the existence of the required agreement but holds that such an agreement is lawful because of the supplier's freedom of trade, see Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is* Sylvania *a Way Out?*, 67 VA. L. REV. 1457, 1476-77 (1981).

94. *See* Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 687-88 (1962).

95. *See supra* text accompanying note 33.

96. *See* Turner, *supra* note 94, at 687-88.

97. *See supra* text accompanying notes 86-90.

98. 362 U.S. 29 (1960).

99. *Id.* at 30-31.

100. *Id.* at 36.

101. *Id.* at 45.

102. *Id.* at 31-32.

103. *Id.* at 32-33.

schedule.[104] When several retailers subsequently refused to follow Parke, Davis' resale price schedule, both Parke, Davis and its wholesalers refused to fill orders from those retailers.[105]

In holding that Parke, Davis' actions were not sheltered by the *Colgate* doctrine, the Court reviewed that doctrine's history.[106] In light of the earlier cases interpreting the doctrine,[107] the Court concluded that it should be applied only where the supplier limits its action to a mere announcement of its policy and a subsequent refusal to deal.[108] The Court ruled that Parke, Davis' conduct went beyond the limited protection provided by the *Colgate* doctrine by involving its wholesalers in the enforcement.[109]

Thus, the analysis used by the Court in *Parke, Davis* limited the *Colgate* doctrine. The doctrine applied only where the supplier went no further than announcing and following a policy of refusing to deal with purchasers who did not comply with the desired resale restrictions. One lower court concluded shortly after *Parke, Davis* that, "[t]he Supreme Court has left a narrow channel through which a manufacturer may pass even though the facts would have to

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104. *Id.* at 33-34.

105. *Id.* at 34. Parke, Davis' efforts to maintain retail resale prices eventually failed. The program was first modified to require only that retailers refrain from advertising prices below those set by Parke, Davis. *Id.* at 35-36. Shortly thereafter, even this limited program was abandoned and retailers were allowed to sell below the prices set by Parke, Davis and to advertise those discounted prices. *Id.* at 36.

106. *Id.* at 38-45.

107. *See*; United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); Federal Trade Comm'n v. Beech-Nut Packing Co., 257 U.S. 441 (1922); Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208 (1921); United States v. Schrader & Son, Inc., 252 U.S. 85 (1920).

108. [The *Bausch & Lomb* and *Beech-Nut* decisions] teach that judicial inquiry is not to stop with a search of the record for evidence of purely contractual arrangements. 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 but only when it is the consequence of a mere refusal to sell in the exercise of the manufacturer's right "freely to exercise his own independent discretion as to parties with whom he will deal." When the manufacturer's actions, as here, go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices, this countervailing consideration is not present and therefore he has put together a combination in violation of the Sherman Act.

362 U.S. at 44.

109. The program upon which Parke Davis embarked to promote general compliance with its suggested resale prices plainly exceeded the limitations of the *Colgate* doctrine and under *Beech-Nut* and *Bausch & Lomb* effected arrangements which violated the Sherman Act. Parke Davis did not content itself with announcing its policy regarding retail prices and following this with a simple refusal to have business relations with any retailers who disregarded that policy. Instead Parke Davis used the refusal to deal with the wholesalers in order to elicit their willingness to deny Parke Davis products to retailers and thereby help gain the retailer's adherence to its suggested minimum retail prices. . . . In thus involving the wholesalers to stop the flow of Parke Davis products to the retailers, thereby inducing retailers' adherence to its suggested retail prices, Parke Davis created a combination with the retailers and the wholesalers to maintain retail prices and violated the Sherman Act.

Id. at 45.

be of such Doric simplicity as to be somewhat rare in this day of complex business enterprise."[110] While the protection provided by the *Colgate* doctrine was still uncertain, it seemed more limited than ever after *Parke, Davis*.

The meaning, extent, and continuing validity of the *Colgate* doctrine has been the object of commentary[111] and judicial opinion.[112] The *Colgate* doctrine and the per se rule against RPM have operated as opposing forces, seemingly incapable of principled reconciliation. One effect of the current debate over the per se rule against RPM is that the *Colgate* doctrine has been vested with renewed vigor.[113]

2. The Distributor-Initiated Scenario — Supplier Response to Distributor Complaints

The *Colgate* doctrine applies to the supplier-initiated scenario, where the supplier acts and the distributor responds. Vertical agreement issues also arise in the distributor-initiated scenario, where the distributor acts and the supplier responds. The distributor usually complains to the supplier about price cutting by another distributor, and the supplier responds by terminating the second distributor. The issue is whether the supplier and the complaining distributor have entered into an agreement. The parties might merely agree that the supplier should terminate the second distributor, or they may also include an implicit term that the complaining distributor will refrain from price cutting.[114]

The distributor-initiated scenario is analytically parallel to the supplier-initiated scenario.[115] The distributor-initiated scenario has not, however, been the object of a long standing doctrine such as the *Colgate* doctrine. The standard

110. George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787, 790 (1960).

111. *See, e.g.*, ABA ANTITRUST SECTION, MONOGRAPH No. 9, REFUSALS TO DEAL AND EXCLUSIVE DISTRIBUTORSHIPS (1983); Baker, *supra* note 92, at 1471-88; Campbell & Ware, Russell Stover *and the Vertical Agreement Puzzle*, 52 ANTITRUST L.J. 83 (1983); Day, *New Theories of Agreement and Combination*, 42 ANTITRUST L.J. 287 (1973); Fulda, *Individual Refusals to Deal: When Does Single-Firm Conduct Become Vertical Restraint?*, 30 LAW & CONTEMP. PROBS. 590 (1965); Greenberg, *Unilateral Refusals to Deal*, 42 ANTITRUST L.J. 305 (1973); Kilburn, *Other Vertical Problems: Pricing, Refusals to Deal, Distribution*, 51 ANTITRUST L.J. 173 (1982); Levi, *The* Parke, Davis-Colgate *Doctrine: The Ban on Resale Price Maintenance*, 1960 SUP. CT. REV. 258 (1960): Pitofsky & Dam, *Is the* Colgate *Doctrine Dead?*, 37 ANTITRUST L.J. 772 (1968); Turner, *supra* note 94, at 684-705; Note, *Refusal to Deal as a Per Se Violation of the Sherman Act:* Russell Stover *Attacks the* Colgate *Doctrine*, 33 AM. U.L. REV. 463 (1984); Note, Russell Stover Candies, Inc. v. Federal Trade Commission: *65 Years Later, Confusion Over the* Colgate *Doctrine Still Persists*, 13 CAP. U.L. REV. 661 (1984); Note, *A Definition of Agreement; Identifying Purely Unilateral Conduct in Vertical Price Restriction Cases*, 19 VAL. U. L. REV. 765 (1985); Comment, *The* Colgate *Doctrine: Its Past and Present*, 12 HOUS. L. REV. 409 (1975); Comment, *Unilateral Refusal to Deal: King* Colgate *is Dead*, 30 OHIO ST. L.J. 537 (1969); *A Definition of Agreement: Identifying Purely Unilateral Conduct in Vertical Price Restriction Cases*, 19 VAL. U. L. REV. 765 (1985).

112. In Russell Stover Candies, Inc. v. FTC, 718 F.2d 256 (8th Cir. 1983), the court reversed an attempt by the Commission to virtually abolish the *Colgate* doctrine in the context of distributor terminations.

113. *See infra* text accompanying notes 189-99.

114. *See infra* note 186.

115. *See infra* text accompanying notes 182-86.

applicable to the conspiracy issues raised by the distributor-initiated scenario remained sufficiently unsettled in 1984 to force the Supreme Court to resolve the conflict among the federal appellate courts.[116]

D. *The Supreme Court's Present Position Regarding Vertical Agreement Issues*

The law applicable to vertical restrictions on competition is complex and dynamic. As a threshold matter, a conspiracy must exist. The conspiracy may arise in either supplier- or distributor-initiated scenarios. If a court finds a conspiracy giving rise to a nonprice vertical restriction, it will judge the restriction under the rule of reason. An RPM conspiracy, however, is per se illegal. All of these concepts come into play in *Monsanto Co. v. Spray-Rite Service Corp.*[117]

1. A Supplier Challenges a Conspiracy Finding in the Distributor-Initiated Scenario and the Solicitor General Challenges the Per Se Rule Against RPM

From 1957 to 1968, Spray-Rite was a wholesale distributor of Monsanto herbicides.[118] In 1968, Monsanto refused to renew Spray-Rite's distribution contract.[119] Spray-Rite sued Monsanto and alleged that this refusal resulted from a conspiracy between Monsanto and at least one other distributor to fix the distributor resale price for Monsanto herbicides. Further, Spray-Rite alleged that this conspiracy was per se illegal under section 1 of the Sherman Act. In answering a special interrogatory, the jury found that Monsanto's termination of Spray-Rite did occur because of a conspiracy.[120] Spray-Rite received a multimillion dollar damage award.

On appeal, Monsanto challenged the sufficiency of the evidence to support the jury's finding of a conspiracy. In upholding the verdict, the court of appeals focused on the distributor-initiated scenario and held that "[p]roof of distributorship termination in response to competing distributors' complaints about the terminated distributor's pricing policies is sufficient to raise an inference of concerted action."[121] Monsanto renewed its challenge to the jury's conspiracy finding before the Supreme Court. It argued that the court of appeals applied the wrong standard and that evidence that a supplier terminated a distributor

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116. Monsanto Co. v. Spray-Rite Serv. Corp., 104 S. Ct. 1464, 1468 (1984).
117. 104 S. Ct. 1464 (1984).
118. *Id.* at 1467.
119. *Id.*
120. *Id.*
121. Spray-Rite Serv. Corp. v. Monsanto Co., 684 F.2d 1226, 1239 (7th Cir. 1982), *aff'd on other grounds*, 104 S. Ct. 1464 (1984). Earlier in its opinion, the court of appeals stated: "We believe, however, that proof of termination following competitor complaints is sufficient to support an inference of concerted action." *Id.* at 1238. Arguably, the two standards are different because the language "in response to" requires a causal link between the complaint and the termination while "following" does not. *See* 104 S. Ct. at 1468 n.4.

in response to a complaint by another distributor does not suffice, standing alone, to support the inference of a conspiracy.

In addition to Monsanto's conspiracy argument, the Solicitor General filed a brief suggesting that the per se rule against RPM should be overturned.[122] The trial court instructed the jury that if it found a conspiracy to fix resale prices of Monsanto products, such a conspiracy would be per se illegal.[123] This instruction was, of course, firmly based on the per se rule against RPM established in *Dr. Miles*. The Solicitor General asserted that the arguments accepted in the *Sylvania* decision with respect to nonprice vertical restrictions applied with equal force to RPM.[124]

Specifically, the brief argued that, because of possible procompetitive effects, per se treatment of RPM was inappropriate.[125] While acknowledging the possibility that RPM could have anticompetitive effects, the Solicitor General contended that both the procompetitive and anticompetitive effects of RPM should be assessed on a case by case basis.[126]

2. The Holding: The Per Se Rule Against RPM Remains Intact and the Conspiracy Finding is Upheld

Despite the arguments presented by Monsanto and the Solicitor General, the Supreme Court held for the plaintiff.[127] The Court refused to abolish the rule against RPM.[128] This, however, does not necessarily mean that the eco-

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122. Brief for the United States as Amicus Curiae in Support of Petitioner at 19-29, Monsanto Co. v. Spray-Rite Serv. Corp., 104 S. Ct. 1464 (1984) [hereinafter cited as Brief for the United States].

123. 104 S. Ct. at 1467.

124. Resale price maintenance can have the same types of procompetitive effects recognized in *Sylvania* as possible consequences of nonprice vertical restraints. By eliminating intrabrand price competition, the manufacturer may enable its distributors to provide costly promotional, warranty, or other ancillary services and thereby increase the attractiveness of the product. Indeed, it is the indirect lessening of price competition by nonprice vertical restrictions that eliminates the free-rider problem and gives such restrictions their procompetitive potential . . . . Price related vertical restrictions in general, and resale price maintenance in particular, accomplish directly what nonprice vertical restraints accomplish indirectly: both types of practice are designed to increase both price and sales volume.

Brief for the United States at 21-22 (footnote omitted).

125. *Id.* at 24.

126. *Id.* at 23-24.

127. 104 S. Ct. at 1473. The Court determined that the plaintiff presented sufficient evidence to support a jury verdict in its favor. *Id.*

128. The Solicitor General (by brief only) and several other amici suggest that we take this opportunity to reconsider whether "contract(s), combination(s) . . . or conspirac(ies)" to fix resale prices should always be unlawful. They argue that the economic effect of resale price maintenance is little different from the agreements on nonprice restrictions. See generally *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 69-70, 97 S.Ct. 2549, 2567-2568, 53 L.Ed.2d 568 (1977) (WHITE, J., concurring in the judgment) (citing sources); Baker, Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is *Sylvania* a Way Out?, 67 Va.L.Rev. 1457, 1465-1466 (1981). They say that the economic objections to resale price maintenance that we discussed in *Sylvania, supra*, at 51, n.18, 97 S.Ct. at 2558, n.18 — such that it facilitates horizontal cartels — can be met easily in the context of rule-of-reason analysis.

nomic arguments in favor of RPM had no impact on the Court. Those arguments apparently affected the Court's views on the conspiracy issues presented.[129]

In upholding the verdict, the *Spray-Rite* Court found sufficient evidence to support the jury's conclusion that Monsanto's termination of Spray-Rite occurred because of a price-fixing conspiracy. The Court relied on the cumulative impact of four items of evidence to reach this conclusion:

(1) other distributors complained to Monsanto about Spray-Rite's prices;[130]

(2) Monsanto approached other price-cutting distributors and threatened that unless they maintained suggested resale prices, they would not receive adequate supplies of Monsanto's new corn herbicide;[131]

(3) one of the threatened distributors informed Monsanto that it would maintain the suggested price;[132] and

(4) a distributor newsletter that the Court found could reasonably be interpreted to support the existence of an agreement or understanding that distributors and retailers would maintain pre-set prices or face termination by Monsanto.[133]

Thus, *Spray-Rite* held that the combination of the foregoing evidence sufficiently supported an inference of a conspiracy between supplier and distributor to maintain resale prices and terminate discounters.

3. The Dicta: Evidence of Distributor Complaints Deemed Insufficient and the *Colgate* Doctrine Resurrected

Taken alone, the *Spray-Rite* Court's holding is not troublesome. The Court, however, in expansive dicta, identified two types of evidence that, standing alone, would not support a finding of conspiracy. First, complaints about the terminated distributor to the supplier by non-terminated distributors, while probative, were not alone sufficient to uphold a finding of a conspiracy.[134] The Court thus rejected the rationale of the court of appeals but upheld its judgment in favor of the plaintiff based on the cumulative impact of the evidence of a conspiracy.[135] In so doing, the Court was addressing the conflict between the circuits regarding the adequacy of evidence of distributor complaints to support

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> Certainly in this case we have no occasion to consider the merits of this argument. This case was tried on *per se* instructions to the jury. Neither party argued in the District Court that the rule of reason should apply to a vertical price-fixing conspiracy, nor raised the point on appeal. In fact, neither party before this Court presses the argument advance by amici. We therefore decline to reach the question, and we decide the case in the context in which it was decided below and argued here.

Id. at 1469-70 n.7.

129. *See infra* text accompanying notes 187-99.

130. 104 S. Ct. at 1470-71.

131. *Id.* at 1471.

132. *Id.*

133. *Id.* at 1472.

134. *Id.* at 1470-71.

135. *See supra* text accompanying notes 130-33.

a conspiracy finding.[136] In the Court's view, allowing a trier of fact to infer an RPM conspiracy solely from evidence of distributor complaints about a rival's resale prices could lead to erroneous results. Such evidence might only indicate conduct that was lawful because: (1) only a nonprice vertical agreement is present and the rule of reason is not violated, or (2) under the *Colgate* doctrine, no agreement is present.

The Court's concern that price-related distributor complaints might indicate only nonprice vertical restrictions rather than RPM is understandable. The former are subject to the rule of reason while the latter is per se illegal.[137] While acknowledging this disparate treatment, the Court nevertheless recognized that nonprice restrictions can have price effects.[138] Nonprice vertical restrictions may indirectly raise distributor resale prices by reducing competition among distributors. This increase in price allows distributors to provide the promotional services desired by the supplier. Distributors who believe that the nonprice vertical restrictions do not maintain adequate prices to pay for desired promotional services may complain about discounting by their fellow distributors.[139] The Court stated that these distributor complaints together with evidence of a supplier's interest in its distributors' resale prices do not turn a nonprice vertical restriction into per se illegal RPM.[140]

The Court's second reason was the fear that inferring a conspiracy from distributor complaints would endanger the *Colgate* doctrine by punishing conduct protected by that doctrine.[141] In setting forth its concern for the *Colgate* doctrine, the Court stated the doctrine without limitation.

> This Court has drawn two important distinctions that are at the center of this and any other distributor-termination case. First, there is the basic distinction between concerted and independent action — a distinction not always clearly drawn by parties and courts. Section 1 of the

136. *See supra* note 116 and accompanying text.

137. *See supra* text accompanying notes 21-79.

138. 104 S. Ct. at 1470.

> [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.

Id.

139. *Id.*

> As Monsanto points out, complaints about price-cutters "are natural — and from the manufacturer's perspective, unavoidable — reactions by distributors to the activities of their rivals." Such complaints, particularly where the manufacturer has imposed a costly set of nonprice restrictions, "arise in the normal course of business and do not indicate illegal concerted action."

Id.

140. *See id.* at 1470-71. It is possible to view the Court's discussion of this issue as demonstrating that RPM and nonprice vertical restrictions are so similar that they should be subject to the same standard. *See* Easterbrook, *supra* note 51, at 169-72.

141. 104 S. Ct. at 1469-71.

> Sherman Act requires that there be a "contract, combination . . . or conspiracy" between the manufacturer and other distributors in order to establish a violation. 15 U.S.C. § 1. Independent action is not proscribed. A manufacturer of course generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently. *United States v. Colgate & Co.*, 250 U.S. 300, 307, 39 S. Ct. 465, 468, 63 L.Ed. 992 (1919); cf. *United States v. Parke, Davis & Co.*, 362 U.S. 29, 80 S. Ct. 503, 4 L.Ed.2d 505 (1960). *Under Colgate, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination.*[142]

This passage should be contrasted with the qualified acceptance which the Court gave the *Colgate* doctrine in *Parke, Davis*.[143] A conclusion that may be drawn from the *Spray-Rite* dicta is that a supplier may lawfully coerce compliance with RPM by threats of termination because no agreement would be present. In a later footnote, the Court drew a distinction between coerced acquiescence, not resulting in an agreement, and acquiescence confirmed in a communication requested by the supplier.[144] Under this view of the *Colgate* doctrine, a supplier may threaten a distributor with termination if it fails to comply with the supplier's resale price schedule. The distributor may unwillingly comply with the supplier's demands and tell the supplier that it will comply. No agreement arises so long as the supplier has not asked the distributor to communicate its acquiescence. By approving of this result the Court has resurrected the *Colgate* doctrine in its most pristine form.

The *Spray-Rite* dicta addressed both the distributor-initiated and the supplier-initiated scenarios. In the distributor-initiated scenario, the Court stated that evidence that a supplier responded to distributor complaints in terminating a second distributor is not sufficient standing alone to support the inference of a conspiracy. In the supplier-initiated scenario, the Court rejuvenated the *Colgate* doctrine in an extreme form.

The striking aspect of the *Spray-Rite* Court's approach is that the Court reached conclusions about conspiracy issues without an analysis of what characteristics distinguish concerted conduct from individual action within the meaning of section 1 of the Sherman Act. Such an analysis would have allowed the Court to formulate meaningful conclusions about these issues based upon the reason for the conspiracy requirement. The remainder of this paper sets forth an analysis of the concerted action requirement of section 1 and concludes, first, that the *Colgate* doctrine should be rejected and, second, that the situations

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142. *Id.* at 1469 (emphasis supplied).

143. *See supra* text accompanying notes 98-110.

144. *Id.* at 1471 n.9.

> The concept of a "meeting of the minds" or "a common scheme" in a distributor-termination case includes more than a showing that the distributor conformed to the suggested price. It means as well that evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer.

Id.

where an inference of concerted action between a supplier and a complaining distributor is appropriate can be defined on a principled basis.

Section II will set forth a test for the existence of an agreement under section 1 of the Sherman Act and examine that test in several horizontal contexts in order to assess its validity. Section III will apply the test to the supplier-initiated and distributor-initiated scenarios. Section IV will attempt to explain why the *Spray-Rite* dicta reaches the conclusions it does regarding vertical agreement issues. This explanation is based on the current controversy over the per se illegality of RPM. Case law suggests a test that could identify concerted action.

II. The Test For Concerted Action

A. Copperweld *and* Theatre Enterprises *Suggest a Test*

Shortly after deciding *Spray-Rite,* the Supreme Court handed down an opinion analyzing the foundation of the concerted action requirement of section 1.[145] The Court overturned a long-standing doctrine that would have upheld a finding of conspiracy because it was not supported by that foundation. In *Copperweld Corp. v. Independence Tube Corp.,*[146] the Court addressed the issue of "whether a parent corporation and its wholly owned subsidiary are legally capable of conspiring with each other under § 1 of the Sherman Act."[147] Earlier decisions of the Court seemed to indicate that such a parent and subsidiary were capable of conspiring.[148]

The *Copperweld* Court considered the reasons for the distinction drawn by the Sherman Act between unilateral and concerted conduct. The Court noted at the outset that to allow vigorous competition, the Sherman Act proscribed unilateral conduct only when such activity achieved or approached a monopoly.[149] The Court then explained the stricter scrutiny applied to concerted conduct reflected Congress' concern that such conspiracies would diminish diversity in the directions in which economic power flows by eliminating separate centers of decisionmaking.[150]

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145. *See* Copperweld Corp. v. Independence Tube Corp., 104 S. Ct. 2731 (1984).

146. *Id.*

147. *Id.* at 2734.

148. *See* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968); Kiefer-Stewart Co. v. Joseph E. Seagrams & Sons, Inc., 340 U.S. 211 (1951); Timkin Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. Yellow Cab Co., 332 U.S. 218 (1947).

149. 104 S. Ct. at 2740.

> In part because it is sometimes difficult to distinguish robust competition from conduct with long-run anti-competitive effects, Congress authorized Sherman Act scrutiny of single firms only when they pose a danger of monopolization. Judging unilateral conduct in this manner reduces the risk that the antitrust laws will dampen the competitive zeal of a single aggressive entrepreneur.

Id.

150. *Id.* at 2741.

> The reason Congress treated concerted behavior more strictly than unilateral behavior is readily appreciated. Concerted activity inherently is fraught with anticompetitive risk. It deprives the marketplace of the independent centers of decision-making that competition

Thus, the goal of the conspiracy requirement is to allow section 1 scrutiny of challenged conduct only when the market has been deprived "of the independent centers of decisionmaking that competition assumes and demands."[151] This group behavior receives stricter scrutiny because of the greater danger to competition. Individual behavior is subject to the relatively permissive standards of section 2 of the Sherman Act,[152] while group behavior is examined under more rigorous rule of reason and per se standards of section 1. The test for whether "independent centers of decisionmaking" have been maintained is whether the actors have "pursued their own interests separately."[153]

The Court previously applied the "independent decision making" and "separate interests" standard in *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*[154] An operator of a motion picture theatre alleged that motion picture producers and distributors had conspired to deny it first-run motion pictures. The plaintiff, whose theatre operated in outlying Baltimore, Maryland, alleged that the defendant producers and distributors conspired to license first-run motion pictures only to theatres located in downtown Baltimore. This action limited the plaintiff to subsequent runs. Plaintiff put on no direct evidence of an agreement among the defendants. The plaintiff argued nevertheless a conspiracy could be inferred because all of the defendants acted in the same way: all refused to license first-run pictures to plaintiff. The jury rejected plaintiff's argument and returned a verdict for the defendants. On appeal, the plaintiff contended that the evidence of identical action by the defendants compelled a finding of conspiracy.

Presaging *Copperweld,* the Court couched the issue in terms of independence of decisionmaking in determining whether an agreement, tacit or express, existed.[155] The Court reasoned that identical conduct, while probative, was not

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> assumes and demands. In any conspiracy, two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit. This not only reduces the diverse directions in which economic power is aimed but suddenly increases the economic power moving in one particular direction. Of course, such mergings of resources may well lead to efficiencies that benefit consumers, but their anticompetitive potential is sufficient to warrant scrutiny even in the absence of incipient monopoly.

Id.

151. *Id.*

152. 15 U.S.C. § 2 (1982).

153. 104 S. Ct. at 2741; *see also* Interstate Circuit, Inc. v. United States, 306 U S. 208, 222 (1939) (the Court noted that alleged conspirators each engaged in conduct which was to their advantage only if almost all participated).

> The O'Donnell letter named on its face as addressees the eight local representatives of the distributors, and so from the beginning each of the distributors knew that the proposals were under consideration by the others. Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions for any given territory there was risk of a substantial loss of the business and good will of the subsequent-run and independent exhibitors, but that with it there was the prospect of increased profits.

Id.

154. 346 U.S. 537 (1954).

155. *Id.* at 540. "The crucial question is whether respondents' conduct toward petitioner stemmed from independent decision or from an agreement, tacit or express." *Id.*

dispositive.[156] Turning to a "separate interests" analysis, the Court found the critical question was whether in refusing to license first-run pictures to the plaintiff, each defendant chose conduct in its own self interest regardless of the actions of the other defendants. The defendants presented evidence that downtown theatres could draw a larger audience and thereby generate more revenue for first-run pictures. This evidence supported the inference that in choosing downtown theatres for first-run pictures, each defendant maximized its own benefit regardless of the conduct of other defendants. As a result, the Court found sufficient evidence to uphold the jury verdict.[157] Thus, in *Theatre Enterprises* as in *Copperweld* the Court established an "independent decisionmaking" standard for separating group conduct from individual behavior. It measured this independence by evaluating the extent to which the actors' conduct maximized their self-interest regardless of the conduct of others.[158]

An example outside the business context demonstrates this analysis. If two people, A and B, are observed leaving the same house at the same time, one may ask whether their conduct is concerted or individual. Two contrasting cases demonstrate that the answer depends on further facts. In the first case, A is an armed felon who is using B as a hostage and a shield in leaving the house, which is surrounded by police. The conduct of A and B would be viewed as concerted. A's act of leaving the house maximizes his self-interest only because of B's conduct in acting as a shield. Similarly, B's act of leaving the house under very dangerous circumstances maximizes his self-interest only because of A's act of threatening his life if he refuses. This case demonstrates that two actors' conduct may be concerted even though their acts are not identical and one actor is coerced into acting.

In the second case, A and B are both innocent parties who leave the house because it is on fire. Their conduct is individual not concerted. Leaving a burning house maximizes the self-interest of each actor regardless of the conduct of the other, even if A and B have communicated to each other their intent to leave the building. Further, their conduct remains individual even if one actor would not have acted absent communication from the other actor. For

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156. To be sure, business is admissible circumstantial evidence from which the fact finder may infer agreement. But this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely.

Id. at 540-41 (citations and footnote omitted).

157. *Id.* at 541-42.

Here each of the respondents had denied the existence of any collaboration and in addition had introduced evidence of the local conditions surrounding the [plaintiff's] operation which, they contended, precluded it from being a successful first-run house. They also attacked the good faith of the guaranteed offers of the petitioner for first-run pictures and attributed uniform action to individual business judgment motivated by the desire for maximum revenue. This evidence, together with other testimony of an explanatory nature, raised fact issues requiring the trial judge to submit the issue of conspiracy to the jury.

Id.

158. *See* H. HOVENKAMP, *supra*, note 51, at 99 n.17.

example, assume A is asleep when the fire breaks out and B wakes him up and tells him about the fire. When A and B then both leave the burning house, their acts of leaving are individual rather than concerted actions because each maximizes his individual self-interest by leaving regardless of the conduct of the other. Even though A would not have acted but for the communication from B waking him up, the pair's conduct in leaving the building is not concerted. Leaving is in each actor's individual self-interest. The test is not based merely on communication or causation or a combination of both. When either actor A or B engages in conduct that is in his own self-interest regardless of the conduct of the other, he is acting individually, not as a part of a group.

In the business context, self-interest can be defined as profit maximization. The test for concerted action can thus be phrased as follows: conduct is concerted for purposes of section 1 if its profit maximizing nature depends upon the conduct of others, that is similarly dependent.[159] This test requires more than causation because it is not sufficient that an actor's conduct depends upon the conduct of other actors. The profit maximizing nature of the conduct must also be dependent. For example, A's act of leaving the burning house was dependent on B's act of waking him up. However, the profit maximizing nature of A's act was not so dependent.

As the examples illustrate, a test exists which can determine concerted action. The Court's statements about the *Colgate* doctrine and inferences of concerted behavior in the context of complaining distributors must be measured against this test. First, however, the viability of the dependence test itself must be measured.

B. *Testing the Test*

To assess the effectiveness of the dependence test in determining the existence of concerted action, this subsection will apply it in contexts (1) where concerted action either clearly does or does not exist to see if the test would lead to the same finding, and (2) where there is disagreement over whether concerted action exists to see if the test is consistent with the approach used by more than one side to the dispute.

1. Cartels

Naked price fixing by a cartel is clearly illegal under section 1 of the Sherman Act.[160] Therefore, if the dependence test is viable, it must lead to a finding of concerted action when applied to cartels. In forming a cartel, firms which would otherwise compete attempt to imitate a monopolist by collectively reducing output and raising prices above the competitive level.[161] Because firms in a purely competitive market are small relative to the total size of the market, each individual firm cannot substantially affect total market quantity or market

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159. *Cf.* Turner, *supra* note 94, at 683-84; Comment, *Conscious Parallelism and Price Fixing Defining the Boundary*, 52 U. CHI. L. REV. 508, 522 (1985).

160. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

161. For a basic discussion of competition, monopoly and cartels, see H. HOVENKAMP, *supra*

price. A firm in such a market continues to increase its production until its marginal cost of production equals price. Any move by such a firm to unilaterally hold its production below this point would be irrational because the firm would forego sales on which revenue would exceed cost. Further, the move would not increase the market price.

A monopolist is in a different position. Unlike the firm in a perfectly competitive market, a monopolist controls the total market quantity and its output decisions do affect price. When a monopolist decides how much to produce, it does not compare its marginal cost of production to a constant price. Instead it recognizes that market price will vary depending upon what quantity is produced. A monopolist may therefore hold its quantity short of the point where the marginal cost of producing goods equals price to gain the advantage of an increased price on the quantity it does produce. In short, a monopolist maximizes profits by restricting output short of competitive levels thereby raising price.

A cartel composed of all the firms in an otherwise competitive market can, through cooperation, imitate a monopolist. Each can agree to restrict production to increase prices above competitive levels. This, however, subjects a cartel member to conflicting incentives. The cartel is like a monopolist because the group collectively has monopoly power and the group's profits will be maximized by collectively restricting production. A collective increase in quantity will reduce price. However, each cartel member is a small firm compared to the total size of the market. Like a firm in a competitive market, its individual output decisions do not have a significant effect on price. Because the cartel has raised the market price above marginal costs, an individual firm can increase its profits by reducing its price slightly below the cartel price and substantially expanding its quantity. Of course, if many firms engaged in this price-cutting strategy, market quantity would substantially increase, prices would decrease, and the cartel would eventually collapse. Thus, each firm is subject to the tension created by the rewards available from maintaining the cartel price and the rewards available by cheating on the cartel price and risking the cartel's collapse.

A finding of concerted action results when the dependence test for concerted action under section 1 is applied to firms that join a cartel and comply with its price agreement. Such a cartel member produces only the quantity that it can sell at the cartel price. The member does not shave its price slightly to make further sales at prices that exceed its marginal costs. 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. The production and pricing decisions of each cartel member are similarly dependent. Thus, application of the dependence test demonstrates that an operating cartel is the product of concerted action.

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note 51, §§ 1.1, 1.2 & 4.1, and R. POSNER & F. EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES AND OTHER MATERIALS 4-11, 96-98 (1981).

2. Suggested Prices — Vertical and Horizontal

One apparent inconsistency in the antitrust law is the disparate treatment of suggested prices in the horizontal and vertical contexts. The dependence test for the existence of a conspiracy explains this difference in treatment.[162] In the horizontal context, if one competitor suggests a price to another competitor who voluntarily accepts the suggested price, the two competitors would be held to have engaged in an illegal conspiracy to fix prices. However, if a supplier suggests a resale price to its distributor who voluntarily accepts the suggested resale price, no section 1 violation has occurred. Professor Sullivan views this difference in treatment as anomalous and incorrect.[163] This difference in treatment may be viewed as a mischievous result of the *Colgate* doctrine. Reliance on the *Colgate* doctrine is not necessary, however, because the dependence test explains the difference.

A distributor voluntarily chooses a price because it believes the price will maximize its profits. In coming to this conclusion, the distributor must assess consumer demand for the product, or more specifically, how much of the product consumers will demand at different prices. The supplier may provide this information about demand. In suggesting a resale price, the supplier offers its view of consumer demand. When the distributor voluntarily accepts the resale price suggested by the supplier, the distributor's act depends upon the act of the supplier in a causation sense. The two acts are causally connected in that the distributor might not have charged the suggested price but for the information about consumer demand inherent in the suggestion. Mere causation, however, does not satisfy the dependence test. To satisfy the dependence test, the profit maximizing nature of the distributor's act of voluntarily charging the

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162. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 397 (1977). Professor Sullivan set forth the apparent inconsistency in his treatise.

> While horizontal action tantamount in purpose and effect to price fixing has been characterized as price fixing and held to be *per se* unlawful, this approach has not been applied to vertical contexts. The most obvious example is the widely used practice of manufacturers announcing "suggested" retail prices for their products. So long as nothing more is done, the practice is uniformly regarded as lawful; indeed, unless it is to be frankly overruled, *Colgate* demands at least this. But universal acceptance of the position does not make it consistent with that taken about horizontal restraints. *Socony-Vacuum* instructs that any effort to "tamper" with the free working of the price system is *per se* unlawful. When horizontal restraint is in contemplation these dicta are scrupulously respected. Surely a "suggested" price program which is horizontal in inception and application would violate the law. Yet suggested resale prices are countenanced although the manufacturer can have only one purpose — to affect the price at which dealers resell. Though dealers may or may not universally follow them, surely suggested prices "tend" either to "stabilize" prices at the level selected by the manufacturer or to establish that level as the base price from which discounts are computed. If the law as to vertical restraints were wholly consistent with that as to horizontal restraints, suggested resale prices would be *per se* unlawful.

Id. (footnotes omitted).

Regarding the lawful nature of suggested prices in the vertical context, see DEVELOPMENTS, *supra* note 34, at 60-62, and ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 73-74 (1977).

163. L. SULLIVAN, *supra* note 162, at 399.

suggested price must depend upon the supplier's price suggestion. The profit maximizing character of the distributor's act of charging the suggested price depends only on consumer demand, not on the supplier's price suggestion. The suggested price would have the same maximizing effect on the distributor's profits regardless of whether the distributor chose it because it was suggested by the supplier or because of the distributor's own assessment of consumer demand. Therefore, the application of the dependence test is consistent with the law's conclusion that a distributor does not violate section 1 by voluntarily accepting a resale price suggested by the supplier.[164]

The dependence test is also consistent with finding a conspiracy based on a suggestion that affects prices in the horizontal context. If one competitor suggests a price to another competitor and the second competitor accepts the suggested price, the dependence test finds a conspiracy. Price suggestion can maximize the profits of the first competitor only if the second competitor accepts the price or allows the suggestion to affect its pricing behavior. The profit maximizing character of the second competitor's act of accepting the suggested price depends upon the first competitor also accepting the price or allowing the suggestion to affect its pricing behavior.[165] Therefore, the dependence test is consistent with the current disparate treatment of suggested prices in the vertical and horizontal contexts.

3. Oligopoly Pricing

An oligopoly exists in a market when a few firms control a large share of the total output. Oligopolies differ from monopolies because no single firm has monopoly power. Oligopolies also differ from competitive markets because each each oligopolist is large enough that its production decisions can affect the market price.[166]

The existence of an oligopoly in a market raises special concerns under section 1. First, creation and maintenance of an express cartel is simplified in an oligopolistic market.[167] When only a few firms are needed to achieve monopoly power, the coordination and compliance burdens of the cartel are greatly reduced. Cartels composed of oligopolists can agree on a cartel price and detect cheaters more easily because only a few large firms are involved. Therefore, an effective cartel is more likely in an oligopolistic market than in a competitive market.

The more perplexing problem created by the existence of an oligopoly is whether the oligopolists violate section 1 if they raise prices above competitive levels without ever forming an express cartel.[168] A traditional cartel is based

164. *See* P. AREEDA, ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES, 720 (3rd ed. 1981) ("In the absence of an express agreement or coercion, acquiescent dealers may simply be persuaded of the independent merits of following their supplier's suggestion about price. . . .").

165. The application of the dependence test to horizontal price suggestions is analogous to its application to cartels, *see supra*, text at § II.B.1, and to oligopoly pricing, *see infra*, text at § II.B.3.

166. *See* L. SULLIVAN, *supra* note 162, at 331.

167. *See* R. POSNER, *supra* note 47, at 52.

168. Regarding oligopoly pricing, see F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECO-

on a communicated agreement to charge a price above the competitive level. Oligopolists may be able to keep prices above the competitive level, however, without a traditional communicated agreement. An oligopolist, closely monitoring the conduct of its fellow competitors and anticipating their reactions to changes in price and output, may choose a higher price and lower output without express agreement.[169]

If oligopolists engage in such supra-competitive pricing, an issue is raised as to whether they have violated section 1 of the Sherman Act. Two sides of this oligopoly pricing debate can be compared by examining the divergent positions of Judge Posner and Professor Turner. When oligopolists restrict output and raise prices above the competitive level, Posner would find a section 1 violation even if no communicated agreement is proven.[170] Turner, in contrast, would not find a violation.[171] While they reach dramatically different conclusions, both approaches share one characteristic of importance. They are both consistent with the dependence test for the existence of a conspiracy.

When the dependence test is applied to supra-competitive oligopolistic pricing, it finds concerted action. An oligopolist's act of reducing output and raising its prices above competitive levels will maximize its profits only if the other firms also reduce output and increase prices. If the other firms do not do so, the higher priced firm will lose sales and profits. Thus, the profit maximizing nature of each firm's conduct depends upon the conduct of the other firms in similarly restricting output and raising prices. None of the large firms could

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NOMIC PERFORMANCE ch. 5 (2d ed. 1980); L. SULLIVAN, *supra* note 162, ch. 4; H. HOVENKAMP, *supra* note 51, § 4.2; R. POSNER,, *supra* note 47, ch. 4; Turner, *supra* note 94, at 657-84; Elzinga, *New Developments on the Cartel Front*, 29 ANTITRUST BULL. 3 (1984).

169. P. AREEDA, *supra* note 164, at 272.

> Interdependent decision-making can produce the same unhappy results as monopoly Suppose, for example, a market was made up of five similar one-plant firms with similar costs and sales. If a monopolist with those five plants would maximize profits at a particular price x, would the oligopolists charge any less? Firm Alpha, eager to lower its price somewhat in order to expand its sales, knows that the other four firms would probably reduce their prices too and thus maintain their pre-existing market shares. Unless Alpha believes that it can conceal its price reduction for a time or otherwise gain a substantial advantage from being the first to move, the price reduction would merely reduce its profits. Such "oligopolistic rationality" can not only forestall rivalous price reductions, it can also provide for price increases through, for example, price leadership. If the price had, for some reason, been less than x, firm Beta might announce price x to be effective immediately or in several days or next season. The other four firms may each choose to follow Beta's lead; if they do not increase their prices to Beta's level, it will reduce its price to their level.

Id. (footnote omitted). Areeda notes that this scenario relies upon simplifying assumptions.

> *Caveat.* This simple model is meant to illustrate an important phenomenon about markets inhabited by a few firms. It does not purport to describe any real market, since "oligopolists" behave in complicated ways in responding to varying cost and market conditions. And note that while price is likely to be higher when there are fewer firms than when there are very many, we cannot predict whether an oligopoly's output and price will approach competitive or monopoly levels.

Id. (citation omitted).

170. *See* R. POSNER, *supra* note 47, at 39-77.

171. *See* Turner, *supra* note 94, at 657-73.

keep prices up if others did not go along.[172] Thus, the dependence test is met.[173]

By applying the dependence test to supra-competitive oligopolistic pricing one may conclude that concerted action exists for purposes of section 1. This conclusion is consistent with Posner's view that such pricing violates section 1. According to Posner, oligopolistic pricing is alone sufficient to show a conspiracy because the mutual forbearance required is similar to a unilateral contract recognized at common law.[174] Thus, both Posner and the dependence test would find concerted action in supra-competitive oligopolistic pricing.

Turner would not treat mere supra-competitive oligopolistic pricing as illegal under section 1. While he raises the possibility that this result might be justified on the ground of lack of an agreement, he ultimately rejects this rationale.[175] Instead, he acknowledges that such pricing should be viewed as creating an agreement, but should be treated as lawful for reasons unrelated to the presence or absence of an agreement.[176] Turner uses a dependency analysis to find an

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172. If prices are at a supra-competitive level for some reason other than the coordinated action of the oligopolists (such as a drop in demand), the oligopolists would be able to maintain prices at the level only by reducing output. The reduction in output to maintain a supra-competitive price would be analogous to a reduction in output to create such a price and would be subject to the dependence test on the same basis described in the text.

173. The application of the dependence test to supra-competitive oligopolistic pricing is analogous to its application to cartels, *see supra* text at § II.B.1, and to horizontal price suggestions, *see supra* text at § II.B.2.

174. R. Posner, *supra* note 47, at 71-72.

> If the economic evidence introduced in a case warrants an inference of collusive pricing, there is neither legal nor practical justification for requiring evidence that will support the further inference that the collusion was explicit rather than tacit. Certainly from an economic standpoint it is a detail whether the collusive pricing scheme was organized and implemented in such a way as to generate evidence of actual communications.
>
> The language of section 1 of the Sherman Act, though confined to restraints of trade imposed by "contract, combination . . ., or conspiracy," is not an obstacle to the suggested approach. There is no distortion of accepted meanings in viewing tacit collusion as a form of concerted rather than unilateral activity. If seller A restricts his output in the expectation that B will do likewise, and B restricts his output in a like expectation, there is a literal meeting of the minds, a mutual understanding, even if there is no overt communication. *In forbearing to seek short-term gains at each other's expense in order to reap monopoly benefits that only such mutual forbearance will allow,* A and B are like the parties to a "unilateral contract," which is treated by the law as concerted rather than individual behavior. If someone advertises in a newspaper that he will pay $10 to the person who finds and returns his dog, anyone who meets the condition has an enforceable claim against him to the promised reward. The finder's action in complying with the specified condition is all the indication of assent that the law requires for a binding contract. Tacit collusion is similar: one seller communicates his "offer" by restricting output, and the offer is "accepted" by the actions of his rivals in restricting their outputs as well. I am arguing simply that it may be appropriate in some cases to instruct a jury to find an agreement to fix prices if it is satisfied that there was a tacit meeting of the minds of the defendants on maintaining a noncompetitive pricing policy.

Id. (emphasis supplied).

175. *But see* Markovits, *A Response to Professor Posner*, 28 Stan. L. Rev. 919, 933-35 (1976) (characterizing Turner's view on the presence of an agreement based on supra-competitive oligopolistic pricing as ambiguous).

176. Turner, *supra* note 94, at 671-72.

> I conclude, then, that oligopolists who take into account the probable reactions of

agreement. Because the actions are interdependent an agreement exists.[177]

III. Applying the Test

This section applies the dependence test for a conspiracy to supplier-distributor conduct. First the supplier-initiated scenario, where a distributor complies with the wishes of its supplier because of a perceived threat of termination,

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> competitors in setting their basic prices, without more in the way of "agreement" than is found in "conscious parallelism," should not be held unlawful conspirators under the Sherman Act even though, as in *American Tobacco*, they refrain from competing in price. As a legal conclusion, this could be stated in either of two ways: (1) there is no violation because there is no "agreement"; or (2) there is no violation because, although there is "agreement," the agreement cannot properly be called an unlawful agreement. Either way of formulating the result is supportable. Nevertheless, while there are arguable grounds for saying there is no agreement, there are far better grounds for saying that though there may be "agreement" it is not unlawful agreement. The latter superficially is more difficult to maintain, for if there is agreement it involves "price fixing." But as the discussion indicated, and as the discussion below of such related matters as price systems may indicate more sharply, the main grounds for absolving the behavior have little to do with the question whether agreement is involved. Moreover, the difficulty with the "no agreement" rationale is that the conduct seems equally well described as being an agreement, and the semantics of these terms seem intrinsically incapable of a satisfactory resolution of the question. For me, this is a fatal difficulty, and compels the conclusion that the only convincing rationale for absolving oligopoly pricing rests on other grounds.

Id. For an interesting discussion consistent with Turner's view, see, Carstensen, *Commentary: Reflections on Hay, Clark, and the Relationship of Economic Analysis and Policy to Rules of Antitrust*, 1983 Wis. L. Rev. 953 (commenting upon Hay, *Oligopoly, Shared Monopoly, and Antitrust Law*, 67 Cornell L. Rev. 439 (1982), and Clark, *Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices After* Ethyl Corp., 1983 Wis. L. Rev. 887).

177. In accepting the conclusion that supra-competitive oligopolistic pricing constitutes an agreement under § 1, Turner uses a dependence test.

> The substance of the analysis and contentions made so far may be summarized as follows:
>
> (1) Conscious parallelism is meaningless, and in no way indicates agreement, in the absence of some evidence indicating that the parallel decisions of the alleged conspirators were contrary, on the hypothesis of independent individual decision, to their apparent individual self-interest.
>
> (2) Conscious parallelism contains no element of agreement where what is involved is simply the independent responses of a group of competitors to the same set of facts, "independent" decisions meaning a decision that would have been taken regardless of what competitors decided to do.
>
> (3) Conscious parallelism may reasonably be said to involve an element of agreement where the decisions of each competitor are dependent upon the others making the same decision, and where (as is virtually certain to be the case) the situation is other than that of a near-monopoly firm or of a perfectly symmetrical oligopoly.

Turner, *supra* note 94, at 681. Turner goes on to comment favorably about the use of dependence as a general test for the existence of concerted action under § 1.

> I also find considerable appeal, as a general matter, in defining "agreement" for purposes of Sherman Act law in terms of interdependence of decisions, if for no other reason than that it seems to me to be a clearer and more workable standard than any other standard, of acceptable scope, which requires something more. Once one goes beyond the boundaries of explicit, verbally communicated assent to a common course of action — a step long since taken and from which it would not seem reasonable to retreat — it is

will be examined. The *Colgate* doctrine addresses this scenario. Then, the distributor-initiated scenario, where a supplier responds to a distributor's complaints about a rival by terminating the second distributor, will be analyzed.

A. *The Supplier-Initiated Scenario — The* Colgate *Doctrine Fails the Test.*

The *Spray-Rite* dicta resurrected the *Colgate* doctrine in its most expansive form. That Court stated that concerted action does not exist even though a distributor maintains resale prices announced by the supplier only to avoid termination.[178] This pristine version of the *Colgate* doctrine, under which a supplier may coerce distributor compliance with its demands, must be measured against the dependence test.

The dependence test raises two issues about the conduct of the distributor and the supplier. First, does the profit-maximizing nature of the distributor's act of compliance depend upon the supplier's acts of coercion? The answer to this question is affirmative where the *Colgate* doctrine applies. A distributor sets its price at a level designed to maximize its profits. When it does so without any input from the supplier, or voluntarily in response to the supplier's suggestion,[179] concerted action does not exist. In the *Colgate* doctrine scenario, however, the distributor sets its prices at the level demanded by the supplier only because of threats of termination. Except for the supplier's threats, the distributor would have set its prices at a different, profit-maximizing level. In complying with the supplier's demands, the distributor is still attempting to maximize its profits. The distributor accepts the resale price level demanded by the supplier to avoid the costs that would flow from the threatened termination. Therefore, the profit-maximizing nature of charging the price demanded by the supplier depends upon the supplier's demand and threat of termination. Except for the supplier's demand and threat, the distributor would choose different profit-maximizing price levels. Thus, the profit-maximizing nature of the distributor's act depends upon the supplier's conduct.

The second issue raised by the dependence test is whether the profit-maximizing nature of the supplier's conduct similarly depends on the distributor's conduct. The supplier's imposition of resale prices through a policy of terminating non-complying distributors has costs. Substantial administrative costs arise in developing and enforcing such a program. Further, some otherwise efficient and, therefore, desirable distributors probably will be terminated or voluntarily will cease to do business with a supplier who imposes price restrictions. Other distributors will never commence dealing with the supplier. In the *Colgate* scenario, the resale price demanded by the supplier is not the price that each distributor would have independently selected. Faced with the supplier's demands, presumably some distributors would rather risk termination by failing to comply or will voluntarily switch to another supplier or product.

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extraordinarily difficult if not impossible to define clearly a plausible limit short of interdependence.

Id. at 683.

178. 104 S. Ct. at 1469.

179. *See supra* text at § II.B.2.

The supplier must perceive some benefits that will outweigh these costs. The only potential source of these benefits is the compliance of the distributors. Proponents of RPM would say that these benefits flow from services that distributors will be induced to supply.[180] Even if the supplier is using RPM as an enforcement tool of a distributor or supplier cartel, or is acting upon some other anticompetitive motive, that supplier must expect to gain sufficient benefits from compliance to outweigh the costs of its conduct. Thus, the profit-maximizing nature of the supplier's policy of terminating distributors who do not comply with its announced resale prices depends upon the distributors' compliance. In this circumstance, the dependence test is satisfied by the conduct of both the supplier and the distributor.[181] Applying the dependence test leads to the conclusion that concerted action exists when the supplier coerces compliance with its wishes by threats of termination, a conclusion which is contrary to the *Colgate* doctrine as set forth in the *Spray-Rite* decision.

B. *The Distributor-Initiated Scenario — Applying the Dependence Test in the Complaining Distributor Context*

Applying the dependence test to the distributor-initiated scenario requires a determination of whether concerted action exists when a supplier terminates a distributor in response to complaints by one or more other distributors. The first issue that must be addressed is whether the profit-maximizing nature of the supplier's termination depends upon the distributor's complaint. The dependence test leads to a finding of concerted action only if this is the case. The key to analyzing this issue is recalling that the dependence test requires more than mere causation.

Possibly the distributor's complaint only has a causal relationship with the termination. The distributor's complaint may have merely provided the supplier with otherwise unavailable information about the terminated distributor's conduct.[182] If the supplier believes that its profits will be enhanced if it refuses to deal with distributors that engage in the reported conduct, it will terminate the offending distributor. The complaint caused the termination because, but for the complaint, the supplier would not have known about the terminated distributor's conduct. However, the first step in the dependence test is not satisfied.

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180. *See supra* text accompanying notes 51-63.

181. The analysis set forth in the text applies even if the supplier does not expressly threaten discounting distributors with termination. The essential elements are: (1) the distributor maintains prices at levels different than it would otherwise choose because it perceives a threat of termination if it fails to do so; and (2) this perception results from the supplier's conduct designed to so impress the continuing distributors. So long as both of these elements are present, the profit-maximizing nature of the distributors' conduct depends upon the supplier's conduct and the supplier's conduct is similarly dependent. For example, distributors may perceive such a threat of termination if a supplier engages in a series of terminations obviously motivated by the terminated distributor's pricing practices. *See* Turner, *supra* note 94, at 690-91. If a distributor observing the series of terminations establishes price levels different than those it would otherwise adopt in order to avoid termination, the dependence test is met and concerted action exists.

182. *See* Brief Amicus Curiae of National Agricultural Chemicals Association in Support of Reversal at 7-8, Monsanto Co. v. Spray-Rite Serv. Corp., 104 S. Ct. 1464 (1984).

While the termination depends upon the complaint in a causation sense, the profit-maximizing nature of the supplier's act does not depend upon the complaint. The supplier's reason for the termination is the conduct of the terminated distributor, not the complaint. The supplier would act in the same way regardless of how it learned of the distributor's conduct.[183] If the supplier had discovered the terminated distributor's conduct through its own employees, it would still have terminated the distributor. The profit-maximizing nature of the termination depends upon the terminated distributor's conduct, not upon the complaint.[184] Therefore, applying the dependence test would not lead to a conclusion of concerted action.[185]

The relationship between the distributor's complaint and the termination, however, is not necessarily limited to causation. The profit-maximizing nature of the supplier's act might depend upon the complaint. The supplier might not view the terminated distributor's conduct as adversely affecting the supplier's profits, but rather the supplier might effect the termination to please the complaining distributor. In so doing, the supplier must view pleasing the complaining distributor as a profit-maximizing act. Perhaps the supplier views the complaining distributor as especially valuable or at least more valuable than the terminated distributor. The profit-maximizing nature of the supplier's act of termination depends upon the distributor's complaint, because the fact that the termination resolves the complaint is the key element in making the termination a profit-maximizing act.

The remaining issue is whether the complaining distributor's conduct is similarly dependent. If the distributor's complaint is a profit-maximizing act for the distributor, it must be so because of the supplier's anticipated response. The distributor's complaint could not otherwise affect its profits. Thus, the profit-maximizing nature of the distributor's complaint depends upon the supplier's response.

In summary, the dependence test does not lead to the conclusion of concerted conduct if the supplier would have terminated the distributor no matter how it discovered the distributor's conduct. On the other hand, a finding of concerted behavior is appropriate under the test if the termination maximizes the supplier's profits only because it pleases the complaining distributor. The result of the application of the dependence test in the complaining distributor context depends

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183. The supplier in this situation is analogous to the distributor who voluntarily accepts a suggested resale price. *See supra* text at § II.B.2. The conduct of each is caused by someone who has given them information about some external circumstance. However, the profit maximizing nature of their conduct depends on the external circumstance, not the manner in which they found out about that circumstance.

184. Obviously, concerted action does not exist between the supplier and the terminated distributor because the profit-maximizing nature of the terminated distributor's conduct does not depend upon the supplier's act of termination.

185. As discussed above, a series of such terminations may lead to the perception on the part of distributors of a threat of termination and that perception may coerce compliance with the supplier's perceived wishes. In that case, concerted action would exist between the supplier and the distributors that unwillingly comply. *See supra* note 181.

upon whether the supplier is concerned about the terminated distributor's conduct or the complaining distributor's complaint.[186]

The conclusions of this section regarding the application of the dependence test can be summarized as follows:

1. The *Colgate* doctrine fails the dependence test. A supplier may choose a course of conduct to create a perception that distributors which do not comply with its wishes will be terminated. In such a case, a finding of concerted action between the supplier and the distributors which unwillingly comply is appropriate.

2. A supplier may respond to a distributor complaint by terminating the distributor that is the subject of the complaint. A finding of concerted action between the supplier and the complaining distributor is appropriate if the supplier effects the termination only to please the complaining distributor.

IV. WHY DOES THE *Spray-Rite* DICTA ACCEPT THE *Colgate* DOCTRINE?

The foregoing analysis makes apparent that the conclusions of the dependence test are not consistent with the conclusions of the *Spray-Rite* dicta. The *Spray-Rite* dicta concluded: (1) the *Colgate* doctrine should be resurrected, and (2) evidence that a supplier terminated a distributor in response to complaints by one or more other distributors is not enough to establish concerted action between the supplier and the complaining distributor(s).[187] The dependence test rejects the first conclusion[188] and defines the "something more" required by the second.[189] The dependence test can be viewed as supplementary to the *Spray-Rite* dicta's conclusions in the distributor complaint context.[190] As a result, the most dramatic difference between the dependence test and the *Spray-Rite* dicta is that the dicta accepts the *Colgate* doctrine while the dependence test rejects it. This section will explore that difference.

By accepting the *Colgate* doctrine, the *Spray-Rite* dicta divides the universe of RPM into two distinct parts. RPM accomplished by means of express agreements or implied agreements that do not qualify for protection under the *Colgate* doctrine is per se illegal. However, RPM accomplished by coercing unwilling

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186. If the dependence test leads to the conclusion that the termination was the result of concerted action between the supplier and the complaining distributor, it is important to ask what is the nature of the agreement? The Court must determine whether the agreement which has been established is subject to the rule of reason or a per se standard. The agreement between such a complaining distributor and supplier is at least an agreement to terminate the distributor which is the subject of the complaint. However, no existing per se rule covers a vertical agreement between one distributor and its supplier which merely results in a refusal to deal with another distributor. *See* Oreck Corp. v. Whirlpool Corp., 579 F.2d 126, 133 (2d Cir.), *cert. denied*, 439 U.S. 946 (1978). However, it is possible to argue that, if the nature of the complaint is that the soon-to-be terminated distributor is discounting, the complaining distributor is implying that it will not discount. If such an implied agreement exists, the per se rule against resale price maintenance would presumably apply.

187. *See supra* text accompanying notes 134-44.

188. *See supra* text at § III.A.

189. *See supra* text at § III.B.

190. *Id.*

compliance with announced resale prices through a policy of terminating distributors that do not comply is lawful because no agreement is present.[191] This line between per se illegal RPM and per se legal RPM is not based on the reasons for the concerted action requirement nor any other identified policy.

In *Sylvania*, where the Supreme Court faced the issue of what standards should govern nonprice vertical restrictions, the Court said the resolution of that issue "must be based upon demonstrable economic effect rather than — as in *Schwinn* — upon formalistic line drawing."[192] The same is true for RPM. No demonstrable economic effect justifies granting legality to RPM coerced by threats of termination but treating all other forms of RPM as per se unlawful. Such disparate treatment may be appropriately characterized as "formalistic line drawing." The incongruous nature of the distinction drawn by the *Spray-Rite* dicta will be obvious to any lawyer who must explain it to a client. The client must be told that it is legal to threaten distributors with termination if they do not comply with the supplier's announced resale prices and to terminate noncomplying distributors. However, the client must be informed that it is per se illegal to ask distributors to comply with those same prices and seek and receive assurances that they will do so.[193] The client will correctly perceive no relevant difference between RPM achieved by these two means.[194]

The Supreme Court's endorsement, albeit in dicta, of the foregoing distinction is unsupportable. Perhaps the Court's embrace of the *Colgate* doctrine results from the tension created by the different treatment accorded nonprice vertical restrictions and RPM. The Court may be uncomfortable with the per se illegality currently applied to RPM and may be attempting to create a "safety-valve" by which some RPM will be allowed. While such a rationale does not justify creating a distinction that does not implement the Court's underlying economic rationale, there is a parallel example.

In *Schwinn*, the Court ruled that nonprice vertical restrictions were per se illegal in sale for resale transactions.[195] However, after describing nonprice vertical restrictions as "obviously destructive of competition," the Court held them exempt from per se illegality if they were accomplished by a consignment, rather than a sale for resale.[196] This exemption from per se illegality was necessary, in the Court's view, to allow procompetitive nonprice vertical restrictions.[197]

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191. *See Spray-Rite*, 104 S. Ct. at 1469.

192. 433 U.S. at 59.

193. 104 S. Ct. at 1471 n.9.

194. Professor Levi was correctly troubled by the effect which the *Colgate* doctrine would have on lay persons' views of the law.

> It is a matter of concern also that in an area involving important commercial practice the law should have developed so as to appear to put a premium on the avoidance of words which describe what the parties clearly intend. This must seem strange and degrading to men who take pride in their given word, and it fosters a caricatured view of the law.

Levi, *supra* note 111, at 326.

195. 388 U.S. at 379.

196. *Id.* at 380.

197.
> On the other hand, . . . we are not prepared to introduce the inflexibility which a *per se* rule might bring if it were applied to prohibit all vertical restrictions of territory . . . . Such a rule might severely hamper smaller enterprises resorting to reasonable methods of

Thus, the Court in *Schwinn* established per se illegality for nonprice vertical restrictions but allowed an exception for such restrictions imposed in consignment relationships. The Court was attempting to permit a mechanism that allows for procompetitive nonprice vertical restrictions. The problem, of course, is the distinction that the Court drew between consignments and sales for resale is irrelevant to the difference between procompetitive and anticompetitive restrictions. Both procompetitive and anticompetitive nonprice vertical restrictions can be accomplished through both sales for resale and consignments. Therefore, the line that the Court drew had no relationship to the economic policy it was attempting to further.

The Court recognized this in *Sylvania*. There, the Court overruled *Schwinn* and held that nonprice vertical restrictions are subject to the rule of reason regardless of whether they are imposed on a sale for resale or a consignment. After describing the disparate treatment accorded sale and consignment situations by *Schwinn*, the *Sylvania* court criticized the distinction as unrelated to the competitive effects of vertical restraints.[198]

When the Court in *Spray-Rite* embraces the *Colgate* doctrine, it may be falling into the trap that ensnared it in *Schwinn*. In *Schwinn*, the Court was uncomfortable with the per se illegality it created for nonprice vertical restrictions so it provided an escape through the rule of reason treatment for consignment transactions. In *Spray-Rite*, the Court may be doing the same thing. The Court may be uncomfortable with per se illegality for RPM and may be attempting to provide an escape mechanism by granting per se legality to RPM accomplished by threats of termination through the *Colgate* doctrine. Unfortunately, both the line drawn by the Court in *Schwinn* and the line drawn in the *Spray-Rite* dicta are not based upon the competitive policy that is the foundation of the Sherman Act. It was this policy which the Court correctly relied upon in *Sylvania* to overrule the distinction created in *Schwinn*. This same policy requires that the line established by the embrace of the *Colgate* doctrine in the *Spray-Rite* dicta be abolished. If the Court is uncomfortable with per se illegality for RPM, it should address that issue and establish a rule which is "based upon demonstrable economic effect rather than — as in *Schwinn* — upon formalistic line drawing."[199]

Conclusion

This paper adopts a dependence test for the existence of concerted action for purposes of section 1 of the Sherman Act. This test is supported by the *Copperweld* and *Theatre Enterprises* decisions and is consistent with contemporary analysis of a diverse range of section 1 issues. The dependence test supplements

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meeting the competition of giants and of merchandising through independent dealers, and it might sharply accelerate the trend toward vertical integration of the distribution process.

Id. at 379-80.

198. 433 U.S. at 54. "The Court's opinion [in *Schwinn*] provides no analytical support for these contrasting positions. Nor is there even an assertion in the opinion that the competitive impact of vertical restrictions is significantly affected by the form of the transaction." *Id.*

199. *Id.* at 59.

the "something more" requirement established by the Court in *Spray-Rite* for finding concerted action when a distributor is terminated by its supplier because of complaints by one or more other distributors. The dependence test also leads to the rejection of the *Colgate* doctrine. If the Court is uncomfortable with per se illegality for resale price maintenance, then it should squarely face that issue. It should not turn to a formalistic doctrine unrelated to demonstrable economic effects.