

CHAPTER 3  
VERTICAL PRICE FIXING

The Evolution of per se Illegality

No rule under the Sherman Act is more firmly established than the per se ban on price fixing. Section 1 of the Act proscribes "every contract, combination...or conspiracy in restraint of trade or commerce among the several states."<sup>1</sup> An extended series of court decisions has interpreted this language as making illegal per se all agreements among competing firms to fix prices, to restrict or pool output, to share markets on a predetermined basis, or otherwise to restrict the forces of competition.<sup>2</sup>

The per se rule against express agreements in restraint of trade was initially articulated in the Trans-Missouri Freight Association decision,<sup>3</sup> which was the first price fixing decision to be appealed to the U.S. Supreme Court.<sup>4</sup> In that case, Justice Edward White wrote a strong minority opinion arguing for a "rule of reason," but Justice Peckham, speaking for the majority in a landmark opinion, created the category of "agreements illegal per se." In his majority opinion, Justice Peckham proposed that a restraint be judged by its character, and not by its degree.<sup>5</sup>

While there were a number of important cases after Trans-missouri that reaffirmed the principle that reasonableness has no bearing on the legality of price-fixing agreements among competitors, it was the

<sup>1</sup>26 Stat. 209 (1890), as amended 15 U.S.C.A. Sect.1.

<sup>2</sup> [Scherer, p. 428.]

<sup>3</sup>[ 166 U.S. 290 (1897)]

<sup>4</sup>Scherer, p. 428.

<sup>5</sup> Robert H. Bork, Antitrust Paradox, p. 22.

1927 Trenton Potteries decision that most clearly developed the rationale for a blanket per se rule against price fixing.<sup>6</sup> In that case, the Court again rejected a contention that the "rule of reason" should be applied to a price-fixing arrangement:

The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves the power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow.<sup>7</sup>

In addition, in the Socony-Vacuum case,<sup>8</sup> the Court also observed that the mechanism by which the fixing of prices was effectuated was immaterial, as was the reasonableness of the particular price fixed. Moreover, the Court said that the ban on combinations to control prices even extended beyond a combination that enjoyed a strategic position in the market. ...Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces.<sup>9</sup>

Thus, price-fixing by any group--in whatever form, or for any purpose-- is always and in every respect, illegal in and of itself. There is no excuse.

#### Extending the per se Rule to Vertical Price Fixing

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<sup>6</sup>U.S. v. Trenton Potteries Co., 273 U.S. 377 (1927).

<sup>7</sup>273 U.S. at 397-98.

<sup>8</sup> United States v. Socony- Vacuum Oil Company, 310 U.S. 150 (1940).

<sup>9</sup>310 U.S. at 221.

While the cases cited above were primarily concerned with horizontal combinations among competitors to fix prices, they still reflect a concern with preserving the free play of market forces at each level of the distributive process.<sup>10</sup>

Dr. Miles (1911):

Even before the Trenton Potteries and Socony-Vacuum cases were decided, the Court had considered the problem of vertical price-fixing. In Dr. Miles Medical Company v. John D. Park & Sons Company,<sup>11</sup> the Court granted certiorari to review the dismissal of a bill to restrain Park & Son from inducing wholesalers and retailers who purchased from Dr. Miles from breaking their contracts not to sell Dr. Miles products below a fixed price. Park & Son, a wholesale drug company, had refused to enter into Dr. Miles wholesale consignment contract or retail agency contract. Instead, Park & Sons sought to procure Dr. Miles' medicines at cut prices from purchasers who had entered into these contracts with Dr. Miles. In deciding in favor of Park & Son, the Court conceded that while the manufacturer was not bound to make the product or to sell it to any particular firm or individual, it did not follow that the manufacturer might therefore impose every sort of restriction upon his purchaser since for one thing, ancient common law forbade a general restraint on alienation.<sup>12</sup> This rule of property law traces its lineage all the way back to Coke On Littleton.<sup>13</sup> The original rule concerned itself with arbitrary and severe restrictions on alienation, such as total prohibition of resale. As early as 1711 it was realized that only unreasonable restrictions should be proscribed, and that partial restrictions could be justified when they were ancillary to a legitimate business purpose

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<sup>10</sup>Greene, p. 7182.

<sup>11</sup>220 U.S. 373 (1911).

<sup>12</sup>Greene, p. 7182.

<sup>13</sup>2 Coke, Institutes of the Law of England, Sect. 360- (Day Ed. 1812).

and not unduly anticompetitive in effect.<sup>14</sup> .

Moreover, concluding that the primary benefit of resale price maintenance accrues to the retailer, and not the manufacturer ( a point which many would dispute),<sup>15</sup> the court said:

If there be an advantage to the manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell. As to this, [Dr. Miles] can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit to [Dr. Miles] cannot be regarded as sufficient to support its system [ by which it seeks to maintain prices fixed by it for all the sales of its products at both wholesale and retail]...<sup>16</sup>

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 consumer.<sup>17</sup>

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...And where commodities have passed into the channels of trade and are owned by dealers, the validity of agreements to prevent competition and to maintain prices is not to be determined by the circumstance of whether they were produced by several manufacturers or by one, or whether they were previously owned by one or by many. The [plaintiff] having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic.<sup>18</sup>

Thus, in Dr. Miles, the Court concluded that resale price maintenance is a practice in which the

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<sup>14</sup> See Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347. cited by Justice Stewart in his Schwinn dissent. 35 L.W. 1470 (1967).

<sup>15</sup> See Baxter, p. 24.

<sup>16</sup> Areeda, p. 652.

<sup>17</sup> Areeda, p. 652. Emphasis added.

<sup>18</sup> 220 U.S. at 407-408. Emphasis added.

manufacturer has little economic interest; rather, "the advantage of established retail prices primarily concerns the dealers" and thus is equivalent to a horizontal price fixing agreement among dealers.<sup>19</sup> It is a strange premise on which to build the most important decision in the entire area of vertical price fixing. Justice Stewart's dissent in Schwinn expressed the problem quite well.

Centuries ago, it could perhaps be assumed that a manufacturer had no legitimate interest in what happened to his products once he sold them to a middleman and they had started their way down the channel of distribution. But this assumption no longer holds true in a day of sophisticated marketing policies, mass advertising, and vertically integrated manufacturer-distributors.<sup>20</sup>

We will return to this issue of whether vertical and horizontal price fixing are equivalent in a later section of this chapter when we re-examine the appropriateness of applying the per se rule to vertical price fixing.

#### Refusals to Deal and Agency Agreements

In his perceptive dissent in Dr. Miles, Justice Oliver Wendell Holmes foreshadowed much of the controversy and subsequent development of the law of vertical price-fixing that was to come. It was a powerful dissent which has a strong following to this day.

...There is no statute covering this case; there is no body of precedent that by ineluctable logic requires the conclusion to which the Court has come. The conclusion is reached by extending a certain conception of public policy to a new sphere. On such matters we are in perilous country. I think that, at least, it is safe to say that the most enlightened juridical policy is to let people manage their own business in their own way, unless the ground for interference is very clear....I think that we greatly exaggerate the value and importance to the public of competition in the production and distribution of an article (here only distribution) as fixing a fair price. What really fixes that is the competition of conflicting desires...As soon as the price of something that we want goes above the point at which we are willing to give up other things to have that, we cease to buy it and buy something else. Of course, I am speaking of things we can get along without. There may

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<sup>19</sup>220 U.S. at 407-408.

<sup>20</sup>United States v. Arnold, Schwinn & Co. 35 L.W. 4563, 4571 (1967).

be necessities that sooner or later must be dealt with like short rations in a shipwreck, but they are not Dr. Mile's medicines....The Dr. Miles Medical Company knows better than we do what will enable it to do the best business. We must assume its retail price to be reasonable, for it is so alleged and the case comes here on demurrer....I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not destroy, the production and sale of articles which it is assumes to be desirable that the public should be able to get...<sup>21</sup>

Moreover, in his dissent, Mr. Justice Holmes observed that [Dr. Miles] could have lawfully achieved the same result the Court had just held violative of the Sherman Act "If it should make the retail dealers also agents in law as well as in name, and retain the title until the goods left their hands."<sup>22</sup> In that case there would be no restraint on alienation.

In addition to the above points raised by Justice Holmes, it might also have been argued (though it was not), that the Court left open the question of the legality of resale price maintenance without the explicit contracts that were involved in Dr. Miles? And indeed, in two subsequent cases that raised these very issues, the Court appeared to sanction these alternative means for controlling resale prices.<sup>23</sup>

#### Colgate (1919):

The issue of vertical price fixing without an explicit agreement came before the Court first. In the 1919 Colgate case,<sup>24</sup> the district court had quashed an indictment charging Colgate with "combining with wholesalers and retailers for the purpose and with the effect of procuring adherence on the part of such dealers...to resale prices fixed by the defendant." Colgate had no explicit agreement with its distributors, but it did distribute lists showing uniform prices to be charged, and stated that no sales would be made to those not adhering to these prices and placed the names of offending retailers upon "suspended lists."<sup>25</sup> In dismissing the indictment, the trial court had reasoned 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 would refuse to make further sales to him, as he had the undoubted right to do.<sup>26</sup>

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<sup>21</sup>Areeda, p. 653. Emphasis added.

<sup>22</sup>220 U.S. at 411.

<sup>23</sup> U.S. v. Colgate & Company, 250 U.S. 300 (1919) and U.S. v. General Electric Company, 272 U.S. 476 (1926)

<sup>24</sup> 250 U.S. 300 (1919)

<sup>25</sup>Areeda, p. 713.

<sup>26</sup>250 U.S. 300, ???

In its affirmation of the lower court's decision, the Supreme Court enunciated what has now come to be known as the "Colgate Doctrine:"

...the indictment does not charge Colgate & Company with selling its product to dealers under agreements which obligated the latter not to resell except at prices fixed by the company....

....In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of the trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and of course, he may announce in advance circumstances under which he will refuse to sell.<sup>27</sup>

Obviously, the Colgate decision opened a major loophole in the rigid per se rule of Dr. Miles. In most cases, where the manufacturer sold products that were desired by resellers, the manufacturer could easily effect resale price maintenance without an express contract or agreement by merely exercising his ancient right of refusing to sell to a reseller who did not maintain the specified price. Still this method was not as effective as an explicit vertical price agreement and, of course, when the reseller had to be persuaded to carry the product, it had no consequence at all. Also, as distribution became more complex, and when hundreds of thousands of resellers were involved, the administration of such a system without express contracts became quite difficult. Proof of this point can be adduced from the fact that various commercial interests felt it necessary to prevail upon the Congress and state legislatures to exempt "branded products in free and open competition" from the restrictions of the Dr. Miles decision which had banned resale price contracts out of hand.

General Electric (1926):

The hypothetical consignment case envisioned by Justice Holmes in Dr. Miles materialized in 1926 in the General Electric case.<sup>28</sup> There, the government sought to enjoin General Electric Company and

<sup>27</sup>Areeda, p. 713. Emphasis added.

<sup>28</sup>United States v. General Electric Company 272 U.S. 476 (1926).

Westinghouse Electric & Manufacturing Company and Westinghouse Lamp Company from alleged violations of the Sherman Act due to their system of distribution.<sup>29</sup> As to the consignment practice, as opposed to the patent aspect of the case, the Court held:

There is nothing as a matter of principle or in the authorities which requires us to hold that genuine contracts of agency like those before us, however comprehensive as a mass or whole in their effect, are violations of the Antitrust Act. The owner of an article patented or otherwise is not violating the common law or the Antitrust Law by seeking to dispose of his articles directly to the consumer and fixing the price by which his agents transfer the title from him directly to such consumer.<sup>30</sup>

The Court distinguished Dr. Miles on the ground that the article involved in that case had been sold at full price, and that the retailers were the "complete owners" of the articles.<sup>31</sup>

#### Closing the Loopholes

While vertically imposed price controls found some degree of support in both Colgate and General Electric, both cases were on the whole limited to their facts, since they represented an obvious contradiction in the developing per se ban on horizontal price fixing which reached its peak just one year after General Electric in the 1927 Trenton Potteries decision discussed on p.\_\_\_\_.<sup>32</sup> The Court was obviously uncomfortable with the fact that according to their rulings, a single firm enjoying a substantial share of the market could control the resale price of its products while this same action was a per se violation in the case of a horizontal combination, even though it lacked monopoly power.<sup>33</sup>

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<sup>29</sup>Greene, p. 7183.

<sup>30</sup>272 U.S. at 488.

<sup>31</sup>Greene, p. 7183.

<sup>32</sup>Greene, p. 7183.

<sup>33</sup>Greene, p. 7183.

### Limiting Colgate

The history of the Colgate doctrine is best understood by reference to Dr. Miles Medical Co. You will remember in that case that Dr. Miles entered into written contracts with its customers obligating them to sell its medicine at prices fixed by it. The Court held these explicit contracts were void because they violated both the common law and the Sherman Act. The Colgate decision distinguished Dr. Miles on the ground that the Colgate indictment did not charge Colgate with selling its products to dealers under agreements which obligated the latter not to resell except at prices fixed by the seller. Almost immediately after the Colgate decision the Court began to limit its scope since it created a great deal of confusion and raised doubts about the continuing vitality of the principles announced in Dr. Miles.

### Schrader's Sons (192?):

For example, in United States v. Schrader's Sons,<sup>34</sup> the Court which said that Colgate meant no more than that a manufacturer is not guilty of a combination or conspiracy if he merely "indicates his wishes concerning prices and declines further dealings with all who fail to observe them...", but that there is an unlawful combination "where a manufacturer enters into agreements--whether express or implied from a course of dealing or other circumstances--with all customers...which undertake to bind them to observe fixed resale prices."<sup>35</sup>

### Beech-Nut (192?):

Another example of their waffling on the implications of Colgate is found in Beech-Nut.<sup>36</sup> In that case, the company had adopted a policy of refusing to sell its products to wholesalers or retailers who did not adhere to a schedule of resale prices. Beech-Nut then implemented this policy by refusing to sell

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<sup>34</sup>252 U.S. 85 (1920).

<sup>35</sup>Areeda, p. 491.

<sup>36</sup>Federal Trade Commission v. Beech-Nut Packing Co., 257 U.S. 441 (1921)

to wholesalers who sold to retailers who would not adhere to the policy. To detect violations the company utilized code numbers on its products and instituted a system of reporting. When an offender was cut off, he would be reinstated upon the giving of assurances that he would maintain prices in the future....The company had urged that its conduct was entirely legal under the Sherman Act as interpreted by Colgate. The Court rejected this contention, saying that "the Beech-Nut system goes far beyond the simple refusal to sell goods to persons who will not sell at stated prices, which in the Colgate Case was held to be within the legal right of the producer."<sup>37</sup> The Court held further that the nonexistence of contracts covering the practices was irrelevant since [t]he specific facts found show suppression of the freedom of competition by methods in which the company secures the cooperation of its distributors and customers, which are quite as effectual as agreements express or implied intended to accomplish the same purpose."<sup>38</sup> T]he Court held that the securing of the customer's adherence by such methods constituted the creation of an unlawful combination to suppress price competition among the retailers.<sup>39</sup>

Note that the Court seems to be saying in these cases that while the means to achieve the end is vertical, the end is the suppression of horizontal intrabrand price competition.

Bausch & Lomb (19??):

That Beech-Nut had narrowly limited Colgate and announced principles which subject a producer to Sherman Act liability who secures his customers' adherence to resale prices by methods which go beyond a simple refusal to sell to those customers who will not resell at stated prices, was made clear in U.S. v. Bausch & Lomb Optical Co.<sup>40</sup> Both Beech-Nut and Bausch &

<sup>37</sup>Federal Trade Commission v. Beech-Nut Packing Co., 257 U.S. 441 (192?) [Add page of quote].

<sup>38</sup>Id. p.???

<sup>39</sup>Areeda, p.716.

<sup>40</sup>321 U.S. 707, 722.

Lomb indicate 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. On the other hand, if each customer, although induced to do so solely by a manufacturer's announced policy, independently decides to observe specified resale prices, the policy is legal, even though the economic effect is the same as that accomplished by a prohibited combination. 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." ...<sup>41</sup>

Parke, Davis (1960):

The Colgate loophole was almost completely eliminated in the 1960 Parke, Davis decision.<sup>42</sup> In that case, the Court found that Parke, Davis had gone beyond the simple refusal to deal sanctioned by Colgate. Instead, Parke, Davis used the threat of refusing to deal with its wholesalers to elicit their help in cutting off price-cutting retailers, and thereby to gain the retailers' adherence to Parke, Davis' suggested minimum retail prices.<sup>43</sup> The names of the offending retailers were supplied to the wholesalers by Parke, Davis. This the court said created a combination in violation of the Sherman Act.<sup>44</sup>

...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 retailers' adherence to its suggested minimum retail prices. The retailers who disregarded the policy were promptly cut off when Parke, Davis supplied the wholesalers with their names. The large retailer who said he would "abide" by the

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<sup>41</sup>United States v. Parke, Davis & Company, 362 U.S. 29 (1960), Areeda, p. 716.

<sup>42</sup>U.S. v. Parke, Davis & Co., 362 U.S. 29 (1960)

<sup>43</sup>Greene, p. 7185.

<sup>44</sup>For cases following Parke, Davis see Note 10 in Greene, p. 7185.

price policy was not cut off. 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.<sup>45</sup>

Parke, Davis illustrates the Court's continuing reluctance to countenance conduct, that, when successful, results in two- party conduct that would be unlawful when effected by express agreement.<sup>46</sup> For all practical purposes Parke, Davis closed the Colgate loophole. On its face, it left a narrow Colgate channel through which a manufacturer may pass, but the behavior would have to be of such "Doric simplicity" as to be quite rare in today's complex business enterprise.<sup>47</sup>

While Parke, Davis achieved the Court's end of effectively closing the Colgate loophole, it left a number of problems for the orderly and predictable development of the law which produced a flood of legal commentary. In a sense, it was a contrived decision. It clearly was a case of bending and stretching the facts to achieve a larger public policy purpose. It is a perfect example of the Court's creative use of the term "agreement" to get to a result that is not to be found by an objective assessment of the facts of the case. The problem with going beyond the facts of a specific case to define public policy is well expressed in the Harlan-Frankfurter-Whittaker dissent in the case.

...As to refusals to sell to, the lower court found that such conduct did not involve any concert of action, but was wholly unilateral on Parke, Davis' part. And I cannot see how such unilateral action, permissible in itself, becomes any less unilateral because it is taken simultaneously with similar unilateral action at the retail level....[Moreover the District Court held the] Company did not make "the enforcement of its policies as to any one wholesaler or retailer dependent on the action of any other wholesaler or retailer." And it further stated that the "evidence is clear that both wholesalers and retailers valued defendant's business so highly that they acceded to its policy," and that such acquiescence was not brought about by "coercion" or "agreement". Even were this not true, so that concerted action among the retailers at the "horizontal" level might be inferred...under the principles of interstate Circuit, Inc., v. U.S., 306 U.S. 208, I do not see how that itself would satisfy an inference that concerted action at the "vertical" level existed between Parke, Davis and the retailers and wholesalers...<sup>48</sup>

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<sup>45</sup> Areeda, p. 716. Emphasis added.

<sup>46</sup> Areeda, p. 718.

<sup>47</sup> George W. Warner & Co. v Black & Decker Mfg. Co. 227 F. 2d 787, 790 (2d Cir. 1960), cited in Areeda, p. 719.

<sup>48</sup> United States v. Parke Davis & Co., 362 U.S. 29,?? (1960).

While Colgate was not formally interred by Parke, Davis the subsequent decisions move in that direction.<sup>49</sup> Generally, what the court has done in these and other decisions is to recite the Colgate doctrine and then proceed as if there were a Sherman Act "contract, combination or conspiracy."<sup>50</sup> Since this is a major unsettled issue in the law, we will return to this practice of "finding" agreement where no express price-fixing agreement exists later in this chapter.

Simpson (1964):

Just as Parke, Davis limited Colgate, the 1964 Simpson case limited the General Electric loophole.<sup>51</sup> Simpson was a year- to-year lessee dealer in one of Union's retail service stations. Union required him to sign a consignment agreement under which title to the gasoline remained in Union's name. Union set the retail price and paid the property taxes, but Simpson was liable for everything else including all losses of gasoline except those caused by "acts of God." In its decision, the Court refused to elevate the form of the agreement over its substance.<sup>52</sup> In reaching this result, the Court relied in part on the close scrutiny Congress had given the problem of resale price maintenance, and the narrow ambit within which Congress had legislated it in its "Fair Trade Legislation."<sup>53</sup>

In its opinion, the Court said:

When, however, a `consignment' device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the

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<sup>49</sup> See *United States v. Arnold, Schwinn & Co.* 388 U.S. 365 (1967) and *Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977).

<sup>50</sup> See *Areeda*, p. 719.

<sup>51</sup> *Simpson v. Union Oil Company of California*, 377 U.S. 13 (1964).

<sup>52</sup> *Greene*, p. 7185.

<sup>53</sup> The McGuire Act, 15 U.S.C. Section 45 and the Miller-Tydings Act, 15 U.S.C. Section 1.

`consignment' an agency, for then the end result of U.S. v. Socony-Vacuum Oil Co... would be avoided merely by clever manipulation of words, not by differences in substance. The present coercive `consignment' device, if successful against challenge under the anti-trust laws, furnishes a wooden formula for administering prices on a vast scale.<sup>54</sup>

In Simpson, the Court justified the condemnation of RPM on the grounds that the practice "was being used to [deprive] independent dealers of the exercise of free judgement."<sup>55</sup> Condemned in Dr. Miles because it was thought to be indistinguishable from a retailer cartel; vertical price-fixing was now characterized as a manufacturer's device for exploiting dealers.<sup>56</sup>

In its emphasis of the vastness of the system and the pervasiveness of the price fixing involved, the Court appears to have stopped just short of declaring all devices by which resale price maintenance is accomplished to be violations of the Sherman Act.<sup>57</sup> Certainly, its citation of Socony-Vacuum enunciating the modern prohibitions of horizontal combinations affecting price lends support to this view. Still, since the opinion chose to distinguish General Electric on the grounds that the consignment agreements there involved patented articles, there may still be a limited place for consignment agreements consistent with the Sherman Act.<sup>58</sup> Even if Simpson did not intend to outlaw all devices whereby resale price maintenance is achieved, it must still be read to prohibit vertical price fixing where the risks of the distribution process are borne largely by numerous otherwise independent individuals or firms in

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<sup>54</sup>377 U.S. at 22.

<sup>55</sup>377 U.S. at 16.

<sup>56</sup>Baxter, p. 26.

<sup>57</sup>Greene, p. 7186.

<sup>58</sup>Greene, p. 7186.

competition with others in the sale of a product for which there is a widespread demand on the level of the individual consumer.<sup>59</sup>

A number of cases since Simpson continue the Courts increasing antipathy toward resale price-fixing, and other vertical controls.<sup>60</sup>

Schwinn (1967):

In the 1967 United States v. Arnold, Schwinn & Co.<sup>61</sup> (which has now been overruled by Sylvania with respect to non-price vertical restraints), the Court reaffirmed its position that vertical price fixing is a per se violation of the Sherman Act. In the Schwinn case which held that a bicycle manufacturer's requirement that distributors resell purchased bicycles only to its franchised retailers and that franchised retailers not resell to non franchised dealers constituted a per se violation of Section 1 of the Sherman Act, the Court also held in passing that:

[Even though the issue of unlawful price fixing was not before the Court], were it otherwise--if there were a here a finding that the restrictions were part of a scheme involving unlawful price fixing, the result would be a per se violation of the Sherman Act, U.S. v. Sealy, ante; U.S. v. Bausch & Lomb Co. 321 U.S. 707, 724 (1944). Because of the posture of the case and the failure of the Government to urge the point, we do not here pause to consider whether a case might be presented, short of unlawful price fixing, in which the activities of the manufacturer to affect resale prices--whether styled price "maintenance" or "stabilization" or otherwise--would fatally infect vertical customer restrictions so as to require a conclusion of per se violation.<sup>62</sup>

Schwinn is important primarily because of its ruling that various nonprice vertical restrictions were also per se violations of the Sherman Act. We will deal with this part of the decision in subsequent chapters. Its importance here is that it reaffirms Parke, Davis and adds another nail to the Colgate coffin.

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<sup>59</sup>Greene, p. 7187.

<sup>60</sup>See for example, Albrecht, Schwinn, Sealy, and Bausch & Lomb.

<sup>61</sup>388 U.S. 365, 1967.

<sup>62</sup>35 LW 4564-65, 6-13-67.

Albrecht (1968):

In 1968, Albrecht v. Herald Co.<sup>63</sup> carried still further--some would say to the extreme--the prohibition of resale price maintenance. Albrecht was an independent newspaper distributor who was charging his customers higher prices than those suggested by Herald. As a consequence, Herald employed a third party to solicit Albrecht's customers, and it also assigned certain of Albrecht's customers to another distributor. Herald made it clear that these measures would be discontinued if Albrecht would adhere to the suggested prices. When the case reached the Supreme Court, they held that Herald's actions were not wholly unilateral. Rather, they said, the requirement of Section 1 of the Sherman Act for finding a combination was met by the Herald's employment of the third party and the agreement with the other distributor. The Court thus reaffirmed its earlier holding in Kiefer-Stewart Co. v. Seagram & Sons<sup>64</sup> that per se illegality attaches both to efforts to fix maximum prices and attempts to fix minimum prices. More notable, however, was Albrecht's expansive construction of the term "combination" which many commentators have found at odds with the objectives of the law. More on this point later in the chapter.<sup>65</sup>

The problems with this decision are captured in Justice Harlan's dissent. It is a further example of the "constructive" use of the term "agreement" to reach a conclusion not supported by the objective facts of the case.

[T]he manufacturer who purports to act unilaterally in dictating a maximum price really is acting unilaterally. No one is economically interested in the price squeeze but himself. Had the Court been in the habit of analyzing the economics on which the inference of a combination may be based, it would have seen that even if combinations to fix maximum prices are as illegal as combinations to fix minimum prices, the circumstances under which a combination to fix maximum prices may be inferred are different from those which imply a combination to keep prices up.<sup>66</sup>

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<sup>63</sup>390 U.S. 145 (1968).

<sup>64</sup>340 U.S. 211 (1951).

<sup>65</sup>Greene, p. 7188.

<sup>66</sup>Areeda, p. 731. Justice Douglas concurred.

The Albrecht situation, raises the critical question of how we are to determine whether or not a supplier's conduct is other than unilateral.<sup>67</sup>

The Court relies directly on combinations with Milne and Kroner, two third parties who were simply hired and paid to do telephoning and distributing jobs that the respondent could as effectively have done itself. Neither had any interest of his own in respondent's objective of setting a price ceiling. If the crucial question is whether a company pays one of its own employees to perform a routine task, or hires an outsider to do the same thing, the requirement of a "combination" in restraint of trade has lost all significant meaning....The premise of Section 1 adjudication has always been that it is quite proper for a firm to set its own prices and determine its own territories, but that it may not do so in conjunction with another firm with which it can generate market power that neither would otherwise have. A firm is not "combining" to fix its own prices or territory simply because it hires outside accountants, market analysts, advertisers by telephone or otherwise, or delivery boys. Once it was recognized that Kroner had no interest whatever in forcing his competitors to lower his price, and was merely being paid to perform a delivery job that respondent could have done itself, it is clear respondent's activity was in its essence unilateral.<sup>68</sup>

Earlier, Justice Harlan had argued:

...In a price maintenance situation, each distributor does have an interest in preventing others from breaking the price line and driving everyone's prices down, and there is thus a real symphony of interests behind the pressure exerted on any individual retailer. However, in contrast, the effectiveness of a price ceiling imposed on one distributor does not depend upon the imposition of ceilings on other distributors, be they competitive or not. Each distributor's maximum price agreement is...a vertical matter only, independent of agreements by other dealers.. Hence the result of the Court's theory here would be to make what was done to this petitioner illegal because of the coincidental existence of unrelated similar agreements, and to base petitioner's right to recover upon activities that are altogether irrelevant to whatever harm he has suffered.<sup>69</sup>

This is a convincing dissent and highlights the problems with this decision.

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<sup>67</sup>Areeda, p. 731.

<sup>68</sup>Harlan dissent in Albrecht v. Herald Co., 390 U.S. 145 (1968), Areeda, p. 731.

<sup>69</sup>Harlan dissent in Albrecht, cited in Areeda, p. 730.

Topco (1972):

Schwinn and Albrecht was followed in 1972 by United States v. Topco Associates, Inc.<sup>70</sup> The defendant in that case was an association of small and medium supermarket chains that joined together to obtain merchandise under private labels so that they could more effectively compete with national chains. Even though the case did not involve direct price fixing as such, it is important because the justification often raised by those who would excuse intrabrand price fixing because it may promote interbrand competition was explicitly rejected.

...The fact is that courts are of limited utility in examining difficult economic problems.<sup>71</sup>

...  
Without per se rules, businessmen would be left with little to aid them in predicting in any particular case what courts will find to be legal under the Sherman Act. Should Congress ultimately determine that predictability is unimportant in this area of the law, it can, of course, make per se rules inapplicable in some or all cases, and leave courts free to ramble through the wilds of economic theory in order to maintain a flexible approach.<sup>72</sup>

....  
Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector is one important reason why we have formulated per se rules.<sup>73</sup>

In applying these rigid rules, the Court consistently rejected the notion that naked restraints of trade are to be tolerated because they are well-intended or because they are allegedly developed to increase competition.<sup>74</sup>

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<sup>70</sup>405 U.S. 596 (1972).

<sup>71</sup> United States v. Topco Associates, Slip Opinion, p. 13.

<sup>72</sup> United States v. Topco Associates, Slip Opinion, p.13, n. 10.

<sup>73</sup> United States v. Topco Associates, Slip Opinion, p. 13.

<sup>74</sup> United States v. Topco Associates, Slip Opinion, p.13.

Lehrman (1972):

The findings of per se illegality in Parke, Davis, Simpson, Albrecht, Schwinn, and Topco have implications extending far beyond the fact situations involved in those cases. For example, the 5th Circuit used a Simpson-type analysis" to deal with a complicated system of retail price subsidies which were often used by the Gulf Oil Company to fix retail prices.

In Lehrman v. Gulf Oil Corp.,<sup>75</sup> the Court held that Gulf's withdrawal of temporary price supports constituted "an unlawful coercive effort to secure compliance with Gulf's 'suggested' retail prices."<sup>76</sup>

...even though Gulf had a right to set its own wholesale prices, and arguably had the right to vary its wholesale price in response to competition on the retail level, it did not have the right to extract adherence from its retailers to a schedule of retail prices as a quid pro quo for charging them wholesale prices that would allow them a sufficient margin of profit to stay in business.<sup>77</sup>

Greene (1976):

The 5th Circuit Court of Appeals also used this same kind of expansive Simpson-type of analysis to attack a national account pricing system that was being used by General Foods to control the resale price of its coffee jobbers in their dealings with so called "Multiple Food Service Accounts," like Holiday Inns or other franchised or chain operations.<sup>78</sup>

We will come back to the issue of national account pricing at the end of this chapter. Suffice it to say at this point that the Court held that General Foods' national account system constituted a per se price-fixing violation of Section 1 of the Sherman Act.<sup>79</sup>

<sup>75</sup>464 F. 2d 26 (1972).

<sup>76</sup>464 F. 2d at 38.

<sup>77</sup>Id. p. 38, n. 9.

<sup>78</sup>William E. Greene, v. General Foods Corp. 517 F.2d 635 (5th Cir. 1975), Cert. denied, 424 U.S. 942 (1976).

<sup>79</sup>Greene, p. 7193.

...the teaching of such cases as Simpson and United States v. Masonite Corp., is that the courts in enforcing the antitrust laws must look to the effect a particular business practice has upon competition and not the legal form in which it is cast, in assessing its validity. This General Foods concedes, and attempts to distinguish the Simpson case. If anything, however, Simpson is a weaker case of price fixing than the present one. For in Simpson, Union Oil Company still held title to the gasoline, and therefore arguably had a greater claim to dictate the price to the consuming public. In the present case, General Foods makes no pretense of ownership of the goods that are ultimately sold to the MFSA's; it concedes that title rests in the independent distributor. It cannot be said, therefore that General Foods has any greater warrant to dictate the price of Greene's goods to MFSA's than Union Oil had in Simpson even though it retained title.<sup>80</sup>

#### Closing the "Free-Trade Loophole:

The one big exception to this inexorable march toward the per se illegality of all forms of vertical price fixing was the "Fair-Trade" exemption. In 1937, after a prolonged debate on the competitive effects of resale price maintenance, Congress passed the Miller-Tydings bill which placed "the stamp of approval upon price maintenance transactions under State [fair trade] laws, notwithstanding the Sherman Act of 1890."<sup>81</sup> Troubled by this loophole, in 1951 the Court narrowly construed the Miller-Tydings exemption in Schwegmann Bros. v. Calvert Distillers Corp.<sup>82</sup> Almost immediately thereafter, and as a result of that decision, an overwhelming majority of both houses of Congress passed the McGuire Act which overruled Schwegmann and permitted State fair trade laws to bind even those dealers who refused to sign price maintenance agreements.<sup>83</sup>

In 1975, this glaring loophole was closed with the passage of the Consumer Goods Pricing Act of

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<sup>80</sup>Greene at p.7191.

<sup>81</sup>81 Cong. Rec. 8138 (1937) (statement of Rep. Dirksen); see H.R. Rep No. 382, 75th Cong., 1st Sess. 2 (1937).

<sup>82</sup>341 U.S. 384 (1951).

<sup>83</sup> See H.R. Rep. No. 1437, 82d Cong., 2d Sess. 1-2 (1952) [Baxter, p. 28 note 41.]

1975.<sup>84</sup> In fact, the Court later saw the passage of this act as evidence that the Congress approved of the per se analysis of vertical price restrictions, though the opposite conclusion was not drawn in 1937.<sup>85</sup>

#### The Revival of the Rule of Reason

The stream of cases that we have just considered, represent the zenith of the application of the per se rule to vertical restraints, especially, non-price restraints. However, with the benefit of hindsight it now appears that the Court went too far in applying a "barren formalism" to vertical restrictions "that is artificial and unresponsive to the competitive needs of the real world."<sup>86</sup>

#### Sylvania (1977):

It only remained for new membership on the Court and the right set of facts to bring about a reconsideration of Schwinn. Just such a case was Continental T.V. v GTE Sylvania.<sup>87</sup> Justice Powell's brilliant landmark opinion in Sylvania now governs all current decisions involving vertical restrictions in marketing. However, because the case is primarily concerned with nonprice vertical restrictions, and only incidently deals with resale price maintenance, it will be treated in detail in later chapters. Nevertheless, in passing, the Sylvania Court did suggest possible reasons why resale price maintenance might be treated differently from "nonprice" vertical restraints which are relevant to the issue at hand.

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

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<sup>84</sup>Pub. L. 94- 145 (1975) amending 15 U.S.C. Sect 45(a).

<sup>85</sup>Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1977), note 18.

<sup>86</sup>Baker, "Vertical Restraints in Times of Change: From White to Schwinn to Where?", 44 Antitrust L. J. 537 (1975).

<sup>87</sup>433 U.S. 36 (1977).

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., Mr. Justice Brennan noted that, unlike nonprice restrictions, resale price maintenance is not designed to, but almost always 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.<sup>88</sup>

Notwithstanding its comments, however, the Court neither ruled on the question of resale price maintenance nor reexamined the conflicting justifications posited in Dr. Miles, Simpson, and Albrecht.

Monsanto (1984):

While Sylvania did not directly involve resale price maintenance, and while it did not upset the per se illegality of vertical price fixing, it did return most non-price vertical restrictions to a rule of reason analysis and opened the door for a reconsideration of the application of the per se rule to vertical price fixing. Again, all that was needed was the right set of facts to come before the court. The case that raised the issue of what standard of proof is required for finding a vertical price fixing conspiracy to be in violation of the Sherman Act in light of the Sylvania ruling was Monsanto Co. v. Spray-Rite Service Corp.<sup>89</sup> Again Justice Powell delivered the opinion of the Court.

The case came to the Supreme Court on an appeal from a jury finding that Monsanto, a herbicide manufacturer, had terminated Spray-Rite's distributorship of Monsanto products pursuant to a price fixing conspiracy between Monsanto and one or more of its other distributors's. The Seventh Circuit Court of Appeals affirmed,<sup>90</sup> holding that Spray-Rite's burden of proving a conspiracy to set resale prices was met

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<sup>88</sup>433 U.S. 36, note 18.

<sup>89</sup>104 S.Ct. 1464 (1984).

<sup>90</sup> 684 F. 2d 7th Cir. 1982).

by showing that the termination was in response to or followed from numerous complaints from competing distributors about Spray-Right's price-cutting practices. Needless to say, the Court of Appeals decision permitting a price-fixing agreement to be inferred from the existence of complaints from other distributors (which are always common), or from the fact that termination came about in response to complaints, had the potential to deter or penalize perfectly legitimate conduct. Thus, many saw this case as an opportunity to get the Court to reconsider the per se ban on vertical price fixing that had continued in an unbroken stream of cases since it was first enunciated in Dr. Miles back in 1911.<sup>91</sup> As a result, several amicus briefs were filed in the case, in part with this end in mind. But, as is often the case, the strategy of appeal typically causes certain issues to be dropped along the way, and in part, that is what happened to the request of amici that the Court reconsider whether combinations or conspiracies to fix resale prices should always be unlawful. Since neither party had argued at the trial level that the rule of reason should apply to a vertical price-fixing conspiracy, or raised the point on appeal, it could not be considered by the Supreme Court as has been hoped .

The Solicitor General (by brief only) and several other amici suggested that we take this opportunity to reconsider whether "contract[s], combination[s]...or conspiracies" to fix resale prices should always be unlawful. They argue that the economic effect of resale price maintenance is little different from agreements on nonprice restrictions....They say that the economic objections to resale price maintenance that we discussed in Sylvania --such as that it facilitates horizontal cartels-- can be met easily in the context of rule-of-reason analysis.<sup>92</sup>

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 pressed the argument advanced by amici. We therefore decline to reach the question, and we decide (the case on the basis of?)the context in which it was decided below and argued here.<sup>93</sup>

Unfortunately, then, the most important resale price case of recent times was decided largely on evidentiary terms, and without reference to the landmark Sylvania decision.

In view of Monsanto's concession that a proper finding that nonprice practices were

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<sup>91</sup>220 U.S. 373 (1911).

<sup>92</sup>supra. at 51 n. 18.

<sup>93</sup>104 S.Ct. 1494 , 1469-70 note 7.

part of a price-fixing conspiracy would suffice to subject the entire conspiracy to per se treatment, Sylvania is not applicable to this case. In that case only a non price restriction was challenged. [See 533 U.S. at 51.] Nothing in our decision today undercuts the holding of Sylvania that nonprice restrictions are to be judged under the rule of reason. In fact, the need to insure the viability of Sylvania is an important consideration in our rejection of the Court of Appeal's standard of sufficiency of evidence. See infra, at 1470.<sup>94</sup>

One wonders what the chances for a revision of Dr. Miles would have been. At least we know how Justice Brennan felt, since in his concurring opinion he said:

As the Court notes, the solicitor General has filed a brief in this Court as amicus curiae urging us to overrule the Court's decision in Dr. Miles Medical Co. v. John D. Park & Sons Co. 220 U.S. 373 (1911). That decision has stood for 73 years, and Congress has certainly been aware of its existence throughout that time. Yet Congress has never enacted legislation to overrule the interpretation of the Sherman Act adopted in that case. Under these circumstances, I see no reason for us to depart from our longstanding interpretation of the Act...<sup>95</sup>

We we will address this issue along with others in the following section.

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<sup>94</sup> 104 S.Ct. 1469 n. 6.

<sup>95</sup> 104 S.Ct. 1473.

END NOTES