

CHAPTER 3C

VERTICAL PRICE FIXING CONTINUED

Vertical Price-Fixing Agreements and Refusals to Deal: Has the Colgate Doctrine Outlived its Usefulness?"

In his antitrust text, Professor Areeda contends that the single most litigated issue under the antitrust laws is the existence or nonexistence of a vertical agreement to fix prices and otherwise to restrain trade.¹ He also notes that as this issue has been litigated, it has become clear that there is an interconnection between the rules determining when an agreement is unreasonable and the rules determining when an agreement is to be found. Moreover, as the former become broader and more automatically prohibitive, judges may be sometimes be moved to avoid unwise results by finding there is no agreement and vice versa.²

Often, it appears that a refusal to find concerted action many times represents a judgement by the court that the substantive behavior involved should not be treated as an antitrust violation. Thus there is a tendency to fall back on Colgate whenever the going gets tough in this area.

The rigidities of the per se rule require safety valves for its avoidance in those cases where its application seems inappropriate. One of those safety valves, as we have seen, is the process of characterization: if all price fixing agreements are illegal per se, the courts will refuse to characterize useful price fixing arrangements as price fixing arrangements.³ Another safety valve appears in

¹Phillip Areeda, Antitrust Analysis: Problems, Text, Cases, 3rd. Ed. Boston: Little, Brown & Co. 1981, p. 712.

²Id., p.712.

³ See Broadcast Music, Inc v. Columbia Broadcasting Syatem, 441 U.S. 1. (1979).

connection with the question of concerted action. If joint action that seems useful would constitute a per se violation, many courts will refuse to "find" the joint action.⁴

The issue of whether or not "agreement" exists has been a recurring antitrust problem because illegality under the Sherman Act is typically predicated upon the existence of an agreement to restrain trade. In fact, the Congress which wrote the Sherman Act directed its main thrust against business conduct involving two or more parties. (For a summary of this historical background see Rahl, "Conspiracy and the Antitrust Laws," 44 Ill. L. Rev., 744- 748 (1950).)⁵

"Agreement" has also been an issue in litigation because attempts have frequently been made to broaden the term to embrace consciously parallel action and refusals to deal even in the absence of an express agreement between the parties?⁶

You will recall, Sherman 1 proscribes every "contract, combination or conspiracy" in restraint of trade. As such, it is strictly confined to joint action. Thus, vertical price-fixing is only illegal insofar as there is a finding that two or more parties may be said to have "agreed" in some way to fix price. If they did not "agree" on the price and if the pricing decisions are unilateral or independently taken, even though they are identical with the prices set by others, they are quite legal inasmuch as "agreement" is an essential ingredient of terms "contract, combination or conspiracy."

With the coverage of the act depending so heavily on the scope given to the term "agreement," it is no surprise to find that the definition of "agreement" has been an important and continuous legal

⁴Liebeler, p. 26-27.

⁵75 HLR 655.

⁶75 HLR 655

battleground. Moreover, changing conditions and a growing economic sophistication have put heavy pressures on a statute drafted with different circumstances and simpler conceptions in mind.⁷

Thus, one of the central unresolved issues in the area of vertical price fixing, and one that persists to this day after years of litigation, is whether and under what circumstances "agreement" can be found from the behavior surrounding a manufacturer's threatened refusal to deal with those distributors who do not resell the manufacturer's product at the suggested resale price.

Is, for example, a series of "vertical agreements" created between an manufacturer who announces that he will refuse to deal with any distributor who fails to abide by his suggested resale price and those dealers who acquiesce in the manufacturer's announced policy? A second problem is whether and under what circumstances the manufacturer and all distributors who have made consciously parallel decisions to acquiesce may be said to have participated in a horizontal conspiracy as well as a vertical agreement.⁸

This problem persists because of contradictory principles laid down in the two leading cases in this area. You will remember that ever since Dr. Miles Medical Co., v. John D. Parks & Sons Co.⁹ was decided by the Supreme Court in 1911, express resale price maintenance contracts between a manufacturer and his distributors have been unlawful per se under the Sherman Act.

On the other hand, ever since the equally significant decision of the Court in U.S. v. Colgate & Co. in 1919, a manufacturer, theoretically at least, has had the right to "announce in advance the circumstances under which it will refuse to sell" and to stop dealing with a distributor for "reasons sufficient to himself."¹⁰ The only stated exception to this rule was that in which the conduct evidenced a purpose to

⁷75 HLR 655.

⁸75 HLR 684.

⁹220 U.S. 373.

¹⁰250 U.S. 300, 307 (1919).

create or maintain a monopoly. Thus in theory at least, any manufacturer, possibly excepting a monopolist, has had the right to announce in advance a policy of dealing only with distributors who abide by a resale price established by him, to refuse to deal further with any distributors who fail to comply, and by such conduct to effect by acquiescence of distributors the same result which, if reached by contract, Dr. Miles had clearly forbidden.¹¹ In practice, however, this right has proved well-nigh illusory. You will recall from the discussion earlier in this chapter that in a long series of cases after Colgate, the Court quickly extended the Dr. Miles rule to implied agreements as well as to formal contracts, and found implied agreements in courses of conduct that showed any substantial element beyond a simple refusal to deal.¹² (These cases are discussed on pp____).

The "classic" example of "finding" agreement where no express agreement existed is, U.S. v. Parke, Davis & Co.,¹³ where Parke, Davis was found to have exceeded the scope of its rights under Colgate, in part, because Parke, Davis had announced that it would refuse to deal with any wholesaler who sold to price-cutting retailers who had been cut off by Parke, Davis and placed on their "list."

Even the absence of "firm and resolute" enforcement of the threatened termination will not always save an announced policy of refusing to deal with offending distributors. Of course, the absence of enforcement could imply that the agreement caused the distributor no damage, or that the termination was due to a legitimate cause.¹⁴ But if there is evidence of coercion, its presence demonstrates that some of the distributors, at least, are being forced to follow the suggestion, and this may turn out to be the

¹¹75 HLR 684.

¹² U.S. v. A. Schrader's Son, Inc. 252 U.S. 85 (1920), extended Dr. Miles to implied agreements. Subsequent cases include FTC v. Beech-Nut Packing Co., 257 U.S. 441 (1922) and others.

¹³ U.S. v. Parke, Davis & Co., 362 U.S. 29 (1960).

¹⁴See for example, Redd v. Shell Oil Co., 524 F.2d 1054, 1057-1058 (10th Cir. 1975) also possibly Blair Foods, Inc. v. Rancher's Cotton Oil, (1980) and Adolph Coors Co. v. FTC, (1974).

evidenciary peg on which a court will hang its finding of agreement.¹⁵

It is even possible in some instances to "find" agreement where the failure to reach agreement is the issue in the case. It sometimes happens, for example, that a manufacturer demands that a dealer contract unlawfully to fix prices, that the dealer refuses, that the manufacturer ceases to sell him, that the dealer's business is thereupon destroyed or reduced, and that he seeks treble damages.¹⁶ Observe that an executed agreement would be unlawful and would support a suit by a participating dealer who later withdrew, to his injury. (The dealer would not be barred by the equitable doctrine of estoppel or in pari delicto from suit by his own participation in the unlawful agreement).¹⁷

Another prime example of the pressure to find "agreement" in such non-agreement cases is illustrated in Albrecht which was also discussed earlier at pp.____.¹⁸

Mr. Justice Harlan's dissent in that case catches the dilemma confronting a court quite well:

...Obviously it makes no sense to deny recovery to a pressured retailer who resists temptation to the last and grant it to one who momentarily yields but is restored to virtue by the vision of treble damages. It is not the momentary acquiescence that does the damage on which recovery is based.

The Court's difficulties on all of its theories stem from its unwillingness to face the ultimate conclusion at which it has actually arrived: it is unlawful for one person to dictate price floors or price ceilings to another; any pressure brought to bear in support of such dictation renders the dictator liable to any dictatee who is damaged. The reason for the Court's reluctance to state this conclusion bluntly is transparent: this statement of the

¹⁵Areeda, p. 719.

¹⁶Areeda, p. 726.

¹⁷See Greene, p. 7178.

¹⁸Areeda, p. 727.

matter takes no account of the absence of a combination or conspiracy...¹⁹
And of course, if there was no combination or conspiracy, there would be no violation of Sherman 1.

The latest major example of the "finding" of agreement in a refusal to deal case is Monsanto discussed on pp.____. In that case, you will remember, the terminated distributor, Spray-Rite, charged that Monsanto conspired with certain of its well-behaved dealers to implement a resale price maintenance scheme, and that Spray-Rite was terminated for price cutting. Monsanto defended its termination of Spray-Rite as a unilateral act prompted by Spray-Rite's failure to satisfy Monsanto's announced distribution criteria.²⁰

After making its usual obeisance to Colgate, and after a full discussion of the evidentiary standards required to find agreement, the Court nonetheless "found" agreement on the basis of what many would regard as pretty scanty evidence.²¹

...something more than evidence of complaints [from dealers] is needed. There must be evidence that tends to exclude the possibility that the manufacturer and the nonterminated distributors were acting independently. As Judge Aldisert has written [in Sweeney v. Texaco] the antitrust plaintiff should present direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others "had a conscious commitment to achieve an unlawful objective."²²

In a footnote on the same page, the Court explained:

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.

The Court then continued:

¹⁹Need Albrecht citation [Areeda, p. 731.]

²⁰Cite Monsanto here.

²¹Id. p. 1471.

²² See Edward J. Sweeney & Sons, supra, at 111; accord H.L. Moore Drug Exchange v. Eli Lilly & Co. 662, F.2d 935, 941 2nd Cir. 1981) cert. denied, 459 U.S. 880, 103 S.Ct. 176, 74 L. Ed.2d 144 (1982); cf. American Tobacco Co. v. U.S., 328 U.S. 781, 810, 66 S.Ct. 1125, 1139, 90 L.Ed. 1575 (1946) (Circumstances Must reveal "a unity of purpose or a common understanding, or a meeting of minds in an unlawful arrangement")

Applying this standard to the facts of this case, we believe there was sufficient evidence for the jury reasonably to have concluded that Monsanto and some of its distributors were parties to an "agreement" or "conspiracy" to maintain resale prices and terminate price-cutters...²³

Obviously, these post-Colgate cases cannot be fitted together in any rational way and it is futile to try. There is of course an element of obvious truth in Colgate, which is that a simple refusal to deal, standing alone, is not a vertical agreement. Actually, the very fact that there was a refusal to deal indicates there has been a failure to obtain agreement. Consequently, if this were all Colgate stood for, there would be no difficulty in reconciling the cases. But from day-one, Colgate was thought to stand for much more, as the convoluted reasoning of later cases seeking to avoid the implications of Colgate make clear. This is what makes Colgate and subsequent decisions so difficult to reconcile.²⁴ The Court has been trying to prevent the "obvious truth" enunciated in Colgate from overruling Dr. Miles. In fact you will remember that immediately after Colgate in the Schrader case,²⁵ the Court expressly stated that it had no intention in the Colgate case of overruling Dr. Miles. This position was reaffirmed in the Frey and the Beech Nut cases.²⁶

The short of the matter is that once Dr Miles was applied to tacit as well as express agreements, any tenable line between "agreements" and compliance with a manufacturer's stated wishes wholly disappears.²⁷ The distinction between a program of resale price maintenance effected by contracts and "agreements," and one effected by threats of refusal to deal, is illusory unless "agreement" is defined so as

²³104 S.Ct. 1464, 1471 (1984).

²⁴75 HLR 686.

²⁵United States v. Schrader & Sons Inc., 252 U.S. 85 (1920).

²⁶Frey and Sons v. Cudahy Packing Company __U.S.__,1921, and FTC v. Beech Nut Packing Company, __U.S.__, 1922.

²⁷75 HLR 688.

to exclude tacit or implied agreements. This the Court has not done because such a distinction fails as a policy measure effectively to separate invidious from noninvidious resale price maintenance.²⁸

Since, for antitrust purposes, the Court makes no distinction between express price-fixing agreements and resale price maintenance systems achieved by a threat of refusal to deal, why, then, has the Court repeatedly declined to overrule, or at least limit Colgate to the obvious proposition that only a bare refusal to deal, as such, does not involve agreement?²⁹ To do so would help provide a useful coherence to this important stream of cases and help managers who are looking for predictability in their distribution policies. This is a gain which should not be undervalued gain since it would help managers design distribution systems in accordance with predictable legal standards. As Dean Levi has noted:

...it is a matter of concern that the law should have failed to provide itself with a meaningful structure of theory. Beyond this, it is a matter of concern also that in an area involving important commercial practice the law should have developed so as to put a premium on the avoidance of words which describe what the parties intend.³⁰

There are at least two reasons why the Court has left Colgate in place and then proceeded to bracket it with this "agreement" ploy. One is that there is real merit in protecting the right of a seller to deal with those with whom he chooses as a general rule. In fact, it may be one of the essential tenets of a competitive market economy that economic units within it be free to deal or not deal as circumstances indicate. It is hard to visualize its operation without this "right."

Another objection to overruling the Colgate doctrine is that it might subject all manufacturers to the harassment of a virtual flood of treble-damage actions from distributors cut off for any reason at all.³¹

²⁸75 HLR 686-87.

²⁹ 75 HLR 688.

³⁰Levi, "The Parke, Davis - Colgate Doctrine: The Ban on Resale Price Maintenance," in The Supreme Court Review 258 at 325 (Kurland ed. 1960).

³¹75 HLR 690.

Both of these reasons appear to be ill founded. Prof. Turner is correct when he says that there are no serious legal or practical barriers standing in the way of overruling Colgate insofar as it may protect programs of resale price maintenance effected by refusals to deal. In fact, all significant considerations indicate that because of the uncertainty it engenders, this aspect of Colgate at least should be sent to a long-overdue repose.³²

In any event, the courts should make it perfectly clear, Colgate notwithstanding, that a policy of refusing to deal with price cutters is no more nor less than an invitation to agree on resale price which, if it produces the desired acquiescence in a minimum price, results in unlawful agreements. The manufacturer should not be compelled to deal with anyone; he simply should not be allowed to make resale price maintenance a decisive factor in deciding with whom to deal.³³

Whether induced by threat of refusal to deal or not, acquiescence in a seller's policy of resale price maintenance should be enough to establish vertical agreement between the buyer and the seller.³⁴ In fact, if one would continue to restrict resale price maintenance, this seems to be the only sensible course. If a manufacturer induces acquiescence by his distributors in a policy of resale price maintenance, he has clearly created a series of tacit vertical agreements, and it seems wholly irrelevant to that conclusion that he obtained these tacit agreements by threats of refusal to deal, carried out against those who refused to acquiesce.³⁵

While there is clear merit in protecting the right of a seller to deal with whom he chooses, there is even

³²571, 75 HLR 691.

³³ 75 HLR 689.

³⁴75 HLR 705-706.

³⁵75 HLR 689.

greater merit in not allowing him to refuse to deal for any reason that suits him in those situations where refusal induces compliance in a course of action that offends public policy. It should be the position of the courts that the right to refuse to deal, like all rights, is subject to the limitations imposed by regulatory statutes.³⁶

The freedom to deal or not deal as a principle presupposes mutual free choice, that is, a range of reasonably comparable alternatives available to buyers and sellers on both sides of the bargain. When this is not true, refusal to deal may become economically coercive. In fact disproportionate bargaining power is almost inevitably signalled by a threat of refusal to deal which induces another to make substantially different decisions in running his own business than he would otherwise make. This is probably the main reason why the Court has refused to make even a bare refusal to deal an inalienable right.

Moreover, with respect to the objection that narrowly limiting Colgate would lead to a deluge of private treble-damage termination suits, this can be handled by imposing on private plaintiffs the burden of establishing the existence of a clear policy or pattern of refusals to deal which have in fact resulted in resale price maintenance by a substantial number of distributors, and of directing verdicts against plaintiffs whenever the burden has not been met.³⁷

Finally, controversy exists over whether "agreement" should be found in uniform resale prices established by the consciously parallel behavior of participating resellers. You will remember that as one reason for invalidating resale price-maintenance contracts in Dr. Miles, the Court stressed the fact that the resulting identity of prices charged by dealers resembled the case in which dealers horizontally conspire to fix prices. Nearly thirty years later in Interstate Circuit v. United States,³⁸ the Court had before it another case in which a group of competitors had responded in identical fashion to a demand by a party standing in a vertical relationship to them. While the Court held that the district court's finding of actual agreement among the competitors was amply supported by the record, it went on to say in dictum:

[I]n the circumstances of this case such agreement...was not a prerequisite to an unlawful

³⁶75 HLR 689.

³⁷75 HLR 690.

³⁸306 U.S. 208 (1939).

conspiracy. It was enough that knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that others were asked to participate; each knew that cooperation was essential to successful operation of the plan....Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.³⁹

This language was later relied on in United States v. Masonite Corp.⁴⁰ where the Court held that a price-fixing conspiracy was established by a series of vertical agency agreements in which the patentee, Masonite Corporation, licensed makers of competitive products to distribute patentee's products at prices set by the patentee:

But for Masonite's patents and the del credere agency agreements, there can be no doubt that this is a price-fixing combination which is illegal per se under the Sherman Act...That is true though the District Court found that in negotiating and entering into the first agreements each appellee, other than Masonite, acted independently of the others, negotiated only with Masonite, desired the agreement regardless of the action that might be taken by any of the others, did not require as a condition of its acceptance that Masonite make such an agreement with any of the others, and had no discussion with any of the others. It is not clear at what precise point of time each appellee became aware of the fact that its contract was not an isolated transaction but part of a larger arrangement. But it is clear that as the arrangement continued each became familiar with its purpose and scope.⁴¹

³⁹603 U.S. 208 (1939) at 226-27.

⁴⁰316 U.S. 265 (1942).

⁴¹316 U.S. 265 at 275-75 (1942).

Superficially, the language of these cases (Interstate Circuit and Masonite), suggesting identification of "conscious parallelism" with conspiracy, covers like a blanket the dealers who participate in a manufacturer's resale price-maintenance program. To apply Interstate Circuit language, a manufacturer's stated policy of dealing only with distributors who sell at not less than a stipulated price is inevitably, in his approach to each and all distributors, "an invitation to participate in a plan, the necessary consequence of which [in light of Dr. Miles] is restraint of interstate commerce." Moreover each distributor knows "that concerted action is contemplated and invited;" each gives his adherence to and participates in it. A fortiori such a program falls within the minimal elements held to be vertical- horizontal conspiracy in Masonite.⁴²

It may not seem inappropriate to say that dealers who enter into vertical resale price-fixing agreements, knowing that their competitors are doing likewise, are joining a price-fixing conspiracy, even where the dealers are coerced into the conspiracy by the economic loss they would suffer from being cut off if they failed to comply. Nevertheless, two considerations suggest that this free-wheeling approach to vertical-horizontal conspiracy is questionable.

First, assuming proper deflation of Colgate, the purely vertical agreements between the manufacturer and each dealer would be themselves unlawful; thus, it would be gratuitous. And second, certain kinds of vertical restrictions may have sufficient justification to make per se treatment inappropriate.⁴³

Many feel that consciously parallel decisions by competitors, including even those which are induced by the demand of a buyer from or seller to the group, but which are not interdependent, should

⁴²75 HLR 696.

⁴³75 HLR 696.

not be held to constitute a horizontal agreement or participation in a vertical-horizontal conspiracy.⁴⁴ They reason that such a holding would put Sherman Act law on a more solid foundation by eliminating "irrational or unworkable distinctions" and direct the court's attention to more relevant factual and policy considerations.⁴⁵

Conscious parallelism, per se, is meaningless and should not be interpreted to imply agreement, in the absence of some evidence that the parallel decisions of the alleged conspirators were contrary to their apparent individual self-interest, arrived at independently. Consciously parallel behavior should not be considered "agreement" if it is merely an independent response to the same set of facts. But, of course, if no individual distributor could charge a specific price or successfully engage in a particular practice unless his competitors also follow suit, then there may be conspiracy.⁴⁶ Also see Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939).

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⁴⁴75 HLR 706.

⁴⁵Id., p. 706.

⁴⁶75 HLR 681-683.