



DEPARTMENT OF JUSTICE

VERTICAL PRICE RESTRAINTS

Address by

WILLARD K. TOM
Counselor to the
Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Before the
American Bar Association
Section of Antitrust Law

Washington, D.C.
April 7, 1994

I am delighted to be here today to talk about antitrust enforcement with respect to vertical price restraints. Before I begin, let me just state that the views I will express here are my own, and do not necessarily represent considered positions of the Department of Justice or the Antitrust Division.

Since this is a meeting of the ABA Section of Antitrust, perhaps an appropriate place to begin is with Anne Bingaman's speech before this Section in New York last August, in which she announced the rescission of the Vertical Restraints Guidelines. Those Guidelines, as you know, had purportedly embodied the Division's policies concerning non-price vertical restraints. But they were also animated by a broader attitude that viewed vertical restraints, price and nonprice, as being necessarily benign and even procompetitive. Indeed, the Division had filed, early in the 1980's, an amicus brief urging the Supreme Court to overturn the long-established per se rule against resale price maintenance, and only desisted from such efforts after Congress passed a law forbidding it from expending any funds for any activity "the purpose of which is to overturn or alter the per se prohibition of resale price maintenance."¹

AAG Bingaman's speech rejected both aspects of the Vertical Restraints Guidelines, its non-price text and its price-related subtext. With respect to vertical price restraints, she declared:

[B]oth Congress and the Supreme Court have had recent opportunities to change the law. They have not. As a result, my obligation could not be more clear. Henceforth, the Antitrust Division will treat vertical price

¹ Pub. L. No. 98-166, § 510, 97 Stat. 1102 (1983).

fixing as per se illegal under the Supreme Court's decisions in Monsanto and Sharp²

So that is my starting point: vertical price restraints are per se unlawful.

That starting point, of course, gives me a somewhat different perspective from the other two members of the panel, who, as distinguished scholars, are and should be here to give us prescriptions for what the law should be, not necessarily what it is. I do not mean to suggest that there is no role for prosecutorial discretion in antitrust enforcement, and I think it is entirely appropriate that the Antitrust Division, to the extent Congress permits, should play a role in the evolution of the law. But I do think that both principles of stare decisis and our role as law enforcers should make us cautious. The burden should be on those who would change settled law. Yes, it is possible that vertical price restraints may be used to increase dealer promotion and to avoid free-riding on point-of-sale services or on quality certification. But minimum RPM also raises prices to consumers, can be used to facilitate horizontal coordination at the supplier or dealer level, and can distort within-dealer interbrand competition. Right now, the settled law is that the procompetitive possibilities can be achieved less restrictively than by vertical price restraints, or are outweighed by the anticompetitive effects, or the likelihood of both these statements being false is not sufficiently great to outweigh the cost of determining whether they are true or not.

What, then, are the major enforcement issues with respect to vertical price restraints? It seems to me that there are three major ones: (1) what does it take to show concerted action under Section 1 of the Sherman Act, (2) what is the scope of the per se rule, and (3) what factors

² *Antitrust Enforcement, Some Initial Thoughts and Actions, Address by the Honorable Anne K. Bingaman before the Antitrust Section of the American Bar Ass'n*, at 9 (August 10, 1993) (citing *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), and *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988)).

should go into determining whether a practice is unreasonable under the rule of reason or under rules of presumptive illegality?

Let me illustrate those questions a bit. The concerted action issue stems from *Colgate*,³ which held that a manufacturer could announce in advance that it would only deal with distributors who adhered to its pricing policy, and could unilaterally terminate those who departed from it. In the last few years, manufacturers have begun to push the limits of *Colgate*. For example, some of you may have heard of these "three bites at the apple" programs, in which a dealer who violates the manufacturer's pricing policy is first given a warning, then a suspension or fine, and finally termination. For myself, I must confess, I find it difficult to square such programs with Judge Posner's analysis in *Vermont Castings*.⁴ There, the court observed that if a supplier warns a noncomplying dealer to "raise your prices or else," and the dealer "merely grunts, but complies," there is an agreement. To hold otherwise, said Judge Posner, would be to require more to show concerted action under Section 1 of the Sherman Act than is required to prove a contract under the Uniform Commercial Code.⁵

The second issue, the scope of the per se rule, may be illustrated by minimum advertised price programs, in which the dealer agrees not to advertise the product below a specified price, although it remains theoretically free to charge any price it wants once the customer walks in the store. There is clearly an agreement, but is it an agreement as to price or only as to advertising? It doesn't take much imagination to conceive of situations in which the right to charge different

³ *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

⁴ *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158 (7th Cir. 1987), *cert. denied*, 486 U.S. 1005 (1988).

⁵ *Id.* at 1163-64.

prices is merely theoretical. Indeed, to take an absurd extreme, the *Mitsubishi* case⁶ involved, in part, a requirement that dealers place price tags containing Mitsubishi's suggested retail price, and no other price tags, right on the merchandise itself.

Similar concerns are posed by programs under which dealers are paid rebates, but only if they have not discounted from the manufacturer's suggested retail price. That is, they get a rebate if they have been "good," and a lump of coal if they have been bad. There is clearly an agreement of some kind; indeed the agreement would probably be enforceable against the manufacturer if it failed to make good on its promise. The manufacturer would argue, however, that there is no return promise from the dealer, and hence not an agreement "on price or price level" as required by *Sharp*. Again, there may well be circumstances in which that argument is more theoretical than real.

The third issue is equally interesting: how does one determine whether a restraint is unlawful under the rule of reason or under rules of presumptive illegality? *Sharp* dealt only with whether an agreement was per se unlawful or not. But there may be cases in which one can make a judgment that the conduct is harmful to competition without worrying about whether the conduct does or does not fall within the precise contours of the per se rule.

Here it may be useful to review the theories of procompetitive and anticompetitive effect that have been advanced for resale price maintenance. On the procompetitive side, it is argued that a manufacturer may wish to use resale price maintenance to prevent some dealers from free-riding on the point-of-sale services offered by others. For example, where a product is complex, and substantial assistance must be given to the consumer to understand how to use the product and/or to assess its merits, there is a risk that consumers will go into a full-service store, get that

⁶ *Maryland ex rel. Curran v. Mitsubishi Elecs. of Am.*, Civ. No. S-91-815 (D. Md., filed Mar. 27, 1991).

assistance for free, then walk across the street to the discount store and buy the product for substantially less. If this happens on too large a scale, both the manufacturer and consumers as a whole end up worse off—the full-service store can't make a profit on the product, and stops carrying it, and the consumers don't end up getting the information they need.

A variant of this argument, developed in response to the observation that resale price maintenance was often found on products such as designer jeans—where free-rideable point-of-sale services are not obvious—is the quality-certification argument. Under this theory, upscale stores make investments in a reputation for carrying high-quality goods. They employ well-paid and sophisticated buyers to choose their merchandise; they install expensive decorations and amenities in their stores, they engage in image advertising. The fact that these stores carry a product certifies to consumers that the product is of high quality; discount stores can then free-ride on that certification by carrying the same product at lower prices.

Another theory sometimes advanced is that resale price maintenance enables a manufacturer to retain a broader and more stable distribution network than might otherwise be possible, given that dealers may have widely varying cost structures.

I don't mean to suggest that these arguments are necessarily right in a particular case, by the way. There are scholarly debates as to how realistic these scenarios are, and, at least as to core vertical price-fixing, the Supreme Court has implicitly determined that these arguments are not sufficiently important to warrant overturning the *per se* rule. But these are the justifications usually advanced.

On the anticompetitive side of the ledger, there is, first of all, the point that minimum RPM causes prices to consumers rise, at least in the most direct and immediate sense. Thus, if there is no discernible benefit to interbrand competition, the loss to intrabrand competition, and

the consequent rise in price, might itself be deemed to be anticompetitive. This is of particular concern because it prevents efficient distributors from passing on the benefits of that efficiency to consumers. Moreover, resale price maintenance can be used to facilitate cartel-like behavior at either the manufacturer or dealer level. At the manufacturer level, coordination of wholesale prices is often difficult, because it may be hard to detect instances of "cheating" on the price expressly or tacitly set by the group. Widespread adoption of resale price maintenance can make it easier to coordinate pricing by moving the manufacturer-set prices out to the retail level, where they are easier to observe. At the dealer level, dealers who wish to keep prices elevated may find it easier to do so if they can enlist the manufacturer to help police the cartel.

There is some dispute as to the relative likelihood and importance of these pro- and anti-competitive effects, and there are also a number of other theories and variants of such effects, but in the interest of time, I won't go into them here.

What I *would* like to suggest, however, is that one could take these catalogue of effects and find cases in which the competitive effect of an RPM-like restraint is relatively clear, even if we assume *arguendo* that it is not covered by the *per se* rule.

Take, for example, a market that is structurally susceptible to coordination of prices among competing manufacturers. It is relatively concentrated; entry is unlikely or would not be sufficient to disrupt the pricing pattern. Assume further that there are no obvious free-rider problems that could not be solved less restrictively. In that setting, an agreement indirectly achieving widespread intrabrand uniformity of prices might well be deemed economically equivalent to an express agreement on price or price level and hence unlawful, regardless of the precise contours of the *per se* rule.

So what can you expect of the Division with respect to vertical price restraints and restraints that resemble vertical price restraints? First, I think you can expect us to enforce the law as enacted by Congress and interpreted by the courts. Second, you can expect us to be nondogmatic. Outside of the per se area, we will be guided by a careful exploration of the facts, bringing to bear the best investigative and theoretical tools available. As most of you know by now, Anne Bingaman spent most of her professional career as a litigator, and she has a litigator's respect for the importance of facts. It will be very easy for us to follow *Kodak*⁷ in this regard. Over time, of course, such factual exploration may lead to rules, presumptions, and other guidance; I don't mean to minimize the importance of providing certainty, which is one of the virtues of per se rules. Third, you can expect us to be very interested in what you and others have to tell us about what is going on in the marketplace. Our enforcement program can be no better than the quality of the information we receive. We need to know what restraints are being imposed, how they are being enforced, and how they affect the structure and functioning of the distribution system and, more broadly, of a competitive marketplace. I strongly encourage those of you who have clients aggrieved by some of those restraints to contact us.

We cannot promise to bring a case on every complaint you or any other complainant brings to us: we may have honest disagreements about the effects of the practice in question, and resource constraints and other prudential considerations will inevitably place limits on what we may do in some instances. We can, however, promise to listen and investigate with an open mind, and to prosecute vigorously where we see conduct that we believe impedes competition and harms consumers.

⁷*Eastman Kodak Co. v. Image Technical Services, Inc.*, 112 S. Ct. 2072 (1992).

And for those of you on the other side of the complaints, rest assured that we are proceeding carefully and thoughtfully. We honestly want to understand the effects of the restraints, both positive and negative, in the particular market setting, and we really want to hear what you have to say that will help us achieve that understanding. This country probably has the most open and competitive distribution system in the world, to the great benefit of both the businesses and consumers of this country. With your help, we will not only keep it that way, but improve it.