tion among dealers. If the dealers are smallish, this competition leads to a relatively larger number of failures. On the other hand, if restricted dealing comes about as part of dealers' cartels—or if it increases dealers' profits in some other way—we expect to see relatively fewer business failures among dealers. We see more failures, so we know competition has become more fierce.

What of other evidence? We would like to know effects on output. If the new information and product tailoring is worth the higher price, then sales will rise despite the increase in price. Market shares of those who use restricted dealing will rise relative to those who do not. If restricted dealing is anticompetitive, sales and shares will fall.

The evidence from the famous cases is illustrative. In the *GTE Sylvania* case, the defendant manufacturer's market share rose consistently after it adopted the challenged practices. In the *Spray-Rite* v. *Monsanto* case, now before the Supreme Court, Monsanto's market share and sales took a dramatic upturn at the time it adopted its practices. The list can be extended.

A more general study backs up this impressionistic information. John P. Gould, now dean of the Graduate School of Business at the University of Chicago, is at work on a large-scale study of restricted dealing in liquor. The variation among state laws provides a natural laboratory for analysis. Dean Gould's data show that the use of restricted dealing is associated with a 10 percent or greater increase in sales, after all other plausible contributing factors have been held constant. Restricted dealing also appears to go hand in hand with a rise in the rate of introduction of new brands.

The evidence is not definitive. Evidence never is. But the evidence is consistent with the theory. It is hard to point to any case in which restricted dealing has injured consumers. It is impossible to tell a coherent story under which restricted dealing does so frequently. Antitrust law therefore should leave manufacturers free to adopt such practices as they choose. Competition, not the courts, best corrects the mistaken judgments of manufacturers. ■

# Why *Dr. Miles* Was Right

**Robert Pitofsky**

IT STRIKES ME THAT when debaters agree on basic premises but disagree on major conclusions—which is the case in this colloquium—it is worth asking why. I would suggest that there are two considerations that split those who want vertical price-fixing to remain per se illegal from those who would make it virtually per se legal. One has to do with whether they take a static or dynamic view of supplier-distributor relationships; the other has to do with whether they recognize the practicalities and limits of the litigation process.

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Let me begin with what I think is a premise that we appear to share. When a manufacturer-supplier sets the resale price to the dealer, it is doing something that, on the face of it, is rather odd. Ordinarily, it would seem, a supplier has everything to gain from fierce and vigorous competition among its distributors. After all, it has already received the wholesale price for its product, and the lower the retail price, the more likely the product will sell. So, why does the supplier not sit back and let its dealers cut each other to shreds?

There are four possible explanations. The first is dealer pressure on the supplier, either overt or anticipated, to participate in what is, in effect, a dealer cartel. The second explanation is that vertical price-fixing is a stabilizing technique for supplier cartels: without it, suppliers will cheat on their cartel by cutting prices in the expectation that dealers will pass the price cuts on to consumers and thereby increase total demand for the product.

A third explanation, the one that Frank Easterbrook emphasizes, is that the supplier decides that its dealers have the wrong mix of price and service and that it can increase its product sales by inducing the dealers to supply more service. This strategy requires controlling the dealers' minimum prices in order to keep some dealers from undercutting the price of those that are more service-oriented and becoming—a fashionable word these days—free riders. In dealing with this situation, which I believe is quite rare, the key question is whether the supplier can serve its legitimate business interests in ways that avoid vertical price-fixing and the anticompetitive effects that come along with it.

The fourth explanation, one that has received less attention in the literature, rejects the premise so often asserted in debates over resale price maintenance—the premise that the manufacturer has no interest in its dealers' prices. I will argue that if one takes a dynamic rather than a static view of relationships between manufacturer-suppliers and their dealers, it becomes clear that the manufacturer-supplier has an interest in the price at which its dealers sell.

Now let me take these explanations one at a time. The first, that dealers press the manufacturer to support a dealer cartel, is hard to document. Vertical price-fixing has been illegal since 1911, and horizontal dealer cartels have been illegal even longer, so there is little point in taking a survey to see how often dealers try to induce vertical price-fixing to achieve dealer cartel effects. Also, dealer pressure can be applied in subtle ways that need not involve overt or coordinated demands. Nevertheless, there is good reason to believe that such pressure exists. For one thing, we find historically that vertical price-fixing has occurred most frequently in industries having well-organized dealer trade associations—indicating that the pressure for resale price maintenance is exerted upward from the dealers rather than downward from the supplier. For another, dealers have a strong incentive to induce the manufacturer to participate in their cartel. Assume that ten dealers in Jordache jeans in an area—high-priced, service-oriented dealers—want to set a price of $32 but that three of them refuse to go along. That cartel is very unlikely to work, because the three will cut prices and increase their sales at the expense of the seven. But if the supplier can be persuaded to participate as a cartel-enforcer, then the three will be denied the product and the dealers that do go along will police each other's prices. The result is a dealer cartel that is stable and therefore effective.

Incidentally, it is a bit misleading to suggest, as Easterbrook does in his essay, that antitrust should be indifferent to vertical price agreements because the same effects are observed in vertically integrated firms. Horizontal price effects can be observed in firms as well—for example, General Motors sets the prices on Pontiacs and Buicks with some view toward coordination. But that is hardly a reason to ignore horizontal cartels between independent competitors.

The second explanation is that suppliers use resale price maintenance in order to enforce their own horizontal price-fixing. While virtually all agree that this happens occasionally, I tend to agree with Easterbrook that it does not happen often. It would require that all the suppliers have similar prices and that the market be rather concentrated—but in fact resale price maintenance is attempted in many markets where neither of these conditions applies. In any event, since this situation certainly does not in itself justify per se illegality, I will forgo extended discussion.

The chief alternative explanation, to which I now turn, is that the manufacturer is somehow the ally of the consumer and that both want the same thing—the proper mix of price and service. Both Easterbrook and Phillip Areeda mention the case of computers, stereos, and the like, and I agree with them that resale price maintenance on such products may not be, on balance, anticompetitive. Consumers shopping for such complex products often collect brochures, information, and advice from the fashionable service-oriented store and then go across the street to Bell or K-Mart and make their purchase at (say) half price. Manufacturers faced with that situation may indeed have a procompetitive motive for vertical price-fixing. I will deal in a moment with how I think the law should treat such cases.

But, as for situations where salesperson explanation is not the service the supplier desires, consider what the explanation really suggests. A manufacturer decides its dealers should be supplying more service. But instead of discussing that with the dealers, instead of contracting with the dealers to provide the service, instead of providing the service itself, the manufacturer imposes vertical price-fixing. And it does this confident that the dealers will know that it wants them to respond by offering specific services—for example, a longer warranty or point-of-sale advertising. So the manufacturer fixes the retail price and, presto, the dealers come up with the right service in the right amount at the right time.

In my view, that scenario is nonsense. In the real world, if suppliers want more advertising or more generous warranties, they and their dealers draw up a contract specifying the terms of a cooperative arrangement or the suppliers provide the services themselves. There may be some services that are difficult to arrange by contract because the transaction costs are so high, but those cases would be extremely rare.

Even if suppliers do occasionally attempt to induce service competition by imposing vertical price restrictions, the question remains whether, as a matter of policy, that should be allowed. Today retailers offer a rich variety of price-service options, ranging from cut-rate no-frill operations to high-priced "prestige" outlets with a lot of services. If we should now permit suppliers to fix resale prices for all stores that sell their product, we would in effect be turning over to the suppliers the decision on the amounts and kinds of service that are needed. It is far better, in my opinion, to leave that decision to the free market. I would add another point. One of the most annoying aspects of this debate is the assumption that the seller with the lowest price offers the least service. It seems to me plausible to assume that discounters often are more efficient and, through price-cutting, pass that efficiency along to consumers. A rule permitting vertical price-fixing (a per se legality rule) would deny the dealer the ability to pass efficiencies along to the consumer—which would, I think, discourage the generation of the efficiency in the first place.

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Let me also compare the arguments that we have heard with reality. The principal argument made by Easterbrook and others who support his view is that the manufacturer's motive is to mix service and price, and that service will not appear in the market because of the free-rider problem. But think for a moment about the product areas in which resale price maintenance has appeared—boxed candy, pet foods, jeans, vitamins, hair shampoo, knit shirts, men's underwear. What are the services we are talking about in these cases? Take jeans. What services does Saks Fifth Avenue provide that K-Mart does not? In both stores, the jeans are laid on the table, customers take them to a dressing room, try them on, and buy them. Is it really plausible that Jordache is fixing the resale price at $32 and denying the product to K-Mart in order to induce Saks to promote services on jeans? I think not.

Clearly the strongest argument against my position is one that Easterbrook mentioned. Where the supplier who engages in vertical price-fixing has only a small market share and its competitors do not also use vertical price-fixing, is it likely that resale price maintenance is induced by dealers to support dealer cartels—and hence is not related (or rarely related) to the service explanation? The problem with that argument has to do with market definition. Take jeans again. Levi and Jordache are in the same market. But that does not mean that the dealers of each branded product have no interest in eliminating intra-brand price competition. Remember, we are talking, for the most part, about retail trade in highly differentiated, highly advertised products. Thus, the dealers of each brand can lose market position and lose profits as a result of competition among themselves, even though they are in some sense in the same market with other groups of dealers specializing in other brands.

Let me turn briefly to the fourth explanation for resale price maintenance—one that challenges the premise that the manufacturer does not care what the resale price is. Let us take the jeans example again, and assume that Jordache charges a wholesale price of $18, that Saks sets a retail price of $32, and that K-Mart then obtains a supply of the jeans and sells them at $22. Is it true that Jordache is indifferent to such price-cutting except to the extent that it inhibits services? I think not, because in the long run Jordache will not be able to hold an $18 wholesale price if the Saks price falls from $30 to $27 to $24. What I am saying is that, in long-run dynamic terms, there is a combination, a partnership, between the supplier and the high-priced dealer, and the supplier knows it.

TO SUM UP, I see no justification for resale price maintenance, based on the service rationale, except in the stereo-audio-computer type of situation where manufacturers probably have a legitimate need to establish resale prices. The challenge is to find a way to accommodate this need.

One possibility, of course, would be to convert the per se illegality rule handed down in the *Dr. Miles* case, which Areeda explains in his essay, to a full rule of reason. My problem with that is the practical one: in this area, a full rule of reason would ensure lengthy and expensive trials. The key question at issue in determining whether to permit a particular instance of resale price maintenance would be market power, and that involves definition of relative market, as well as analysis of entry barriers, potential and existing competition, production capacity, and on and on. As virtually every antitrust lawyer knows, such cases can be made to be extremely expensive and are generally won by the defendant. In other words, rule of reason treatment would probably amount to per se legality, and it would be instituted just to take care of a situation that rarely comes up—the one where the manufacturer desperately needs specific dealer services that cannot be secured in any other way.

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A more sensible approach, I submit, would be to retain the rule of per se illegality and graft onto it a few narrow factual defenses. For example, we could permit a new entrant to use vertical price-fixing, briefly and in a limited way, to get started in a market in which services are important. We could also permit something in the nature of an exception, as we do in the field of horizontal price-fixing, where a product could not exist in the marketplace at all but for the price restriction. With the burden of proof firmly on the defendant, resale price maintenance might be permitted if the defendant could show that a serious free-rider problem was inhibiting its ability to compete and that vertical price-fixing was the best way to eliminate the free-rider problem.

In short I propose a carefully defined exception, usually of limited duration, to the present rule of per se illegality. Now, one might ask, is that all this argument is about? What a tempest in a teapot! But I suggest that the difference between a per se rule with carefully defined exceptions and a full rule of reason is not a tempest in a teapot. As some evidence for the point, let me cite the fact that in the three years since the Antitrust Division and the FTC decided that vertical price-fixing should be treated under a more lenient approach, not per se illegality but a rule of reason, the number of vertical price-fixing cases brought by the two agencies has fallen from an average of about ten a year to zero.

That suggests what the situation would be if we were to make the proposed shift to rule of reason treatment official. Government authorities, acting with the best of will, would rarely find a case they were confident they could prove. Hence, the difference between per se illegality and rule of reason treatment would be, I think, a difference of basic doctrine. Under rule of reason treatment, vertical price-fixing would almost never be illegal at all. ■