

# The True Reagan Antitrust Legacy: The End of Intra-Brand Competition

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In the Summer 2004 issue of ANTITRUST, the departing Editorial Chair, Deborah A. Garza, paid tribute to the antitrust achievements of former President Ronald Reagan.<sup>1</sup> She praised the Reagan administration for “changing the course of federal antitrust enforcement to comport with economic learning and real world facts.”<sup>2</sup> Such an assessment of Reagan’s antitrust legacy calls for a more searching inquiry into the real consequences for antitrust law of the “Chicago School” antitrust theories that were incorporated into law by the Reagan administration and its judicial appointees. Such an inquiry reveals that the Reagan antitrust “revolution” has been a failure, rendering the law unable to prevent, control, or remedy many serious anticompetitive practices.

Although Chicago School theory has had an adverse impact in many areas of antitrust,<sup>3</sup> its most significant effect has been in vertical restraints law, as developed in four major cases: *Continental T.V., Inc. v. GTE Sylvania Inc.*<sup>4</sup>; *Monsanto Co. v. Spray-Rite Service Corp.*<sup>5</sup>; *Business Electronics Corp. v. Sharp Electronics Corp.*<sup>6</sup>; and *State Oil Company v. Khan*.<sup>7</sup> As I have demonstrated at length in other forums,<sup>8</sup> and will summarize below, these cases have virtually eliminated scrutiny of vertical restraints, thus providing no antitrust protection for intra-brand competition. They also have undermined fundamental Sherman Act principles governing horizontal restraints, such as price fixing and classic group boycotts.

The cases listed above need little introduction to readers of this publication. They are the revered pillars of the modern antitrust edifice created by uncritical judicial acceptance of Chicago School theorizing. In fact, as outlined below, the reasoning supporting these cases is seriously flawed, resulting in a profound debilitating effect on antitrust enforcement under Section 1.

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<sup>1</sup> Deborah A. Garza, *Editor's Note*, ANTITRUST, Summer 2004, at 6.

<sup>2</sup> *Id.*

<sup>3</sup> One notable example is the attempted monopolization doctrine under Section 2 of the Sherman Act, as announced in *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993). For discussion of the manifold problems created by the doctrine’s “dangerous probability of success” requirement, see Mark E. Roszkowski & Ralph Brubaker, *Attempted Monopolization: Reuniting a Doctrine Divorced from Its Criminal Law Roots and the Policy of the Sherman Act*, 73 MARQ. L. REV. 355 (1990).

<sup>4</sup> 433 U.S. 36 (1977).

<sup>5</sup> 465 U.S. 752 (1984).

<sup>6</sup> 485 U.S. 717 (1988).

<sup>7</sup> 522 U.S. 3 (1997).

<sup>8</sup> See Mark E. Roszkowski, *The Sad Legacy of GTE Sylvania and its “Rule of Reason”*: *The Dealer Termination Cases and the Demise of Section 1 of the Sherman Act*, 22 CONN. L. REV. 129 (1989) [hereinafter Roszkowski, *Sylvania*]; Mark E. Roszkowski, *Vertical Maximum Price Fixing: In Defense of Albrecht*, 23 LOY. U. CHI. L.J. 209 (1992) [hereinafter Roszkowski, *Albrecht*]; and Mark E. Roszkowski, *State Oil Company v. Khan and the Rule of Reason: The End of Intra-Brand Competition?*, 66 ANTITRUST L.J. 613 (1998) [hereinafter Roszkowski, *State Oil*].

### *GTE Sylvania*

In *GTE Sylvania*, the Court held that the legality of a location clause in a franchise agreement was to be governed by a rule of reason standard. In so doing, the Court overruled *United States v. Arnold, Schwinn & Co.*,<sup>9</sup> which announced a per se standard for vertical nonprice restrictions imposed in conjunction with a sale of goods, and a rule of reason standard for those created in agency and consignment arrangements.<sup>10</sup> In *GTE Sylvania*, the Court justified its rule of reason standard on the basis that although vertical restrictions may stifle intrabrand competition, they may also promote interbrand competition by possibly creating “certain efficiencies” in a manufacturer’s product distribution, enabling it to compete more efficiently with other manufacturers.<sup>11</sup>

The *GTE Sylvania* holding is seriously flawed. Not only is its sole justification (stifling intrabrand competition may promote interbrand competition) likely wrong in fact,<sup>12</sup> its free floating “rule of reason” standard—involving as it does a balancing of actual harm to intrabrand competition against possible or arguable benefits to interbrand competition—is both unprecedented<sup>13</sup> and is incapable of meaningful judicial application.<sup>14</sup> As I have demonstrated in another forum, none of the arguments supporting vertical market division survive serious scrutiny,<sup>15</sup> resulting in their failure to satisfy a traditional, searching “harms, benefits, alternatives”<sup>16</sup> application of the rule of reason.<sup>17</sup> Nevertheless, under the intrabrand-interbrand balancing test endorsed by *GTE Sylvania*—which accepts the pro-vertical restraints arguments as gospel and therefore attaches no weight to the elimination of intrabrand competition—courts have effectively fashioned a rule of per se legality for most vertical restraints. This fact is well illustrated by an exchange between Robert Pitofsky, then Chairman of the Federal Trade Commission, and Kevin J. O’Connor, then Chair of

<sup>9</sup> 388 U.S. 365 (1967).

<sup>10</sup> *Id.* at 380–81.

<sup>11</sup> *GTE Sylvania, Inc.*, 433 U.S. at 54–55.

<sup>12</sup> As Robert Steiner has argued, there is typically “no basis for a sweeping generalization that the net welfare effect of stifling intrabrand competition and stimulating interbrand competition will be favorable.” Robert L. Steiner, *Sylvania Economics—A Critique*, 60 ANTITRUST L.J. 41, 45 (1991). Steiner concludes:

The strength of interbrand competition among manufacturers governs their margins. But even the most vigorous sort of interbrand competition among manufacturers does not discipline retailers’ margins when intrabrand competition is free—much less when it is restrained. Generally, it is the onset of intrabrand competition that *first* forces down the margins and prices of well-known brands. *Then*, interbrand competition—primarily within stores rather than between them—depresses the prices of competing goods.

*Id.* at 44 (emphasis added).

<sup>13</sup> See Roszkowski, *Sylvania*, *supra* note 8, at 153–56. Prior to *Sylvania*, courts had consistently rejected its approach because, as Justice Marshall long ago noted, courts are unable “to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another.” *United States v. Topco Assocs.*, 405 U.S. 596, 609–10 (1972). Economists are no better at such balancing. See Roszkowski, *Sylvania*, *supra* note 8, at 147–49.

<sup>14</sup> See Roszkowski, *Sylvania*, *supra* note 8, at 156–60.

<sup>15</sup> *Id.* at 144–51. These arguments include achieving economies of scale, preventing free riding, historical success, preventing vertical integration, and promoting dealer goodwill.

<sup>16</sup> In applying the rule of reason, Professor Areeda has suggested that virtually all courts apply a three-part analysis:

- (1) What harm to competition results or may result from the collaborators’ activities? (2) What is the object they are trying to achieve and is it a legitimate and significant one? That is, what are the nature and magnitude of the “redeeming virtues” of the challenged collaboration?
- (3) Are there other and better ways by which the collaborators can achieve their legitimate objectives with fewer harms to competition? That is, are there “less restrictive alternatives” to the challenged restraint?

PHILLIP E. AREEDA, THE “RULE OF REASON” IN ANTITRUST ANALYSIS: GENERAL ISSUES 2 (1981); see also PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1502 (1986).

<sup>17</sup> See Roszkowski, *Sylvania*, *supra* note 8, at 160–68.

the NAAG Multistate Antitrust Task Force at the ABA Antitrust Law Section's 1997 Spring Meeting. After noting the value of per se rules in avoiding expense and delay, and in promoting certainty, Chairman Pitofsky stated:

Maximum resale price maintenance is a different matter. Once the Court said that it was legal to allocate territorial zones to your distributors . . . the distributors had much discretion over price and they could raise price if they chose to, and the manufacturer couldn't do anything about it if maximum resale price maintenance is per se illegal.<sup>18</sup>

. . . *the Supreme Court*

Later in the program, Mr. O'Connor responded:

. . . *has, as a result of*

Now, Bob said something that I thought was somewhat revealing. He said that exclusive territories in effect are legal. Well, they're not always legal. They're subject to the rule of reason. I know he knows that. But it is significant that there's an assumption in the profession that if a restraint is in the rule of reason category, it's rarely going to be challenged, and in fact exclusive territories are rarely challenged. . . . [T]he point is, when you put something in the rule of reason category, you're not going to see much litigation in the area, and when you do see it, it's going to be very difficult and costly to resolve.<sup>19</sup>

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Even with its toothless rule of reason standard, *GTE Sylvania* would not be the debilitating decision it has become had it been confined to its holding: nonprice vertical restraints are governed by the rule of reason. Unfortunately, the decision has spawned a series of additional cases that has undermined antitrust enforcement in two additional areas discussed below: dealer terminations and vertical maximum price fixing.

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### The Dealer Termination Cases

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*GTE Sylvania* has had perhaps its most profound impact in an area only tangentially related to the *GTE Sylvania* facts: termination by a common supplier of one retail or wholesale dealer at the request of another dealer or group of dealers, usually because of price cutting by the terminated dealer. Professor Sullivan long ago noted the important distinction between the exclusive franchise and dealer-induced agreements to terminate competitors: "The first commitment forecloses *potential* intrabrand competition only; the second stamps out existing competition at the behest of a firm which is suffering under it."<sup>20</sup> Despite this obvious difference, the Supreme Court, through its decisions in *Monsanto Co. v. Spray-Rite Service Corp.*<sup>21</sup> and *Business Electronics Corp. v. Sharp Electronics Corp.*,<sup>22</sup> has, as a result of an uncritical infusion of *GTE Sylvania* reasoning, virtually eliminated any judicial scrutiny of what has predictably become perhaps the most common and effective form of resale price maintenance.

In *Monsanto*, the Court initially discussed the principles governing dealer termination cases. The first is the distinction between concerted and independent conduct. The former is proscribed under Section 1; the latter is permitted under the *Colgate* doctrine,<sup>23</sup> under which "the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply.

<sup>18</sup> Roundtable Conference with Enforcement Officials, 65 ANTITRUST L.J. 929, 955-56 (1997).

<sup>19</sup> *Id.* at 957-58.

<sup>20</sup> LAWRENCE A. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 427 (1977) (emphasis added).

<sup>21</sup> 465 U.S. 752 (1984).

<sup>22</sup> 485 U.S. 717 (1988).

<sup>23</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination."<sup>24</sup> That is, "[a] manufacturer . . . generally has a right to deal, or refuse to deal, with whom-ever it likes, as long as it does so independently."<sup>25</sup> The second is the distinction between agree-ments to fix resale prices, long per se illegal,<sup>26</sup> and those imposing nonprice restraints, governed by *GTE Sylvania*'s rule of reason standard.

The Court stated that manufacturers and their distributors have "legitimate reasons to exchange information about the prices and the reception of their products in the market"<sup>27</sup> and that the "man-ufacturer's strongly felt concern about resale prices does not necessarily mean that it has done more than the *Colgate* doctrine allows."<sup>28</sup> Permitting inference of conspiracy merely from the existence of complaints or in response to complaints "could deter or penalize perfectly legitimate conduct"<sup>29</sup> and "would . . . inhibit management's exercise of its independent business judg-ment."<sup>30</sup> Accordingly, the Court held that "something more than evidence of complaints is need-ed. There must be some evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."<sup>31</sup>

In *Business Electronics*, the Court erected another procedural barrier to plaintiff recovery in deal-er termination cases, holding that an agreement between a manufacturer and a dealer to terminate another dealer was a per se violation of Section 1 only if the agreement required the surviving deal-er to set prices at a particular level.<sup>32</sup> Both cases suffer from two fundamental flaws: (1) a mis-characterization of a horizontal restraint as vertical; and (2) a usurpation of the jury function. *Business Electronics* introduces another error—a wholly unprecedented definition of price fixing.

**Mischaracterization of Horizontal as Vertical.** The most fundamental error of both *Monsanto* and *Business Electronics* is their failure to recognize that the restraints involved were horizontal price restraints, not nonprice vertical restraints. The dealer termination cases almost all fit the text-book definition of a classic horizontal group boycott, conduct that has always been per se illegal under the Sherman Act.<sup>33</sup> In the classic group boycott, a competitor or group of competitors at one functional level (for example, the complaining *Monsanto* distributors) desire for whatever reason (usually discount pricing) to eliminate a competitor at their level (for example, *Spray-Rite*). To achieve this purpose, the conspirators coercively exert pressure at a functional level above or below them in order to induce a supplier (for example, *Monsanto*) or customer of the boycott vic-tim not to deal with him.

Before the debilitating impact of *GTE Sylvania*, the Court had no trouble recognizing the deal-er termination fact pattern for what it is: "a classic conspiracy in restraint of trade."<sup>34</sup> Now, through

<sup>24</sup> *Monsanto*, 465 U.S. at 761.

<sup>25</sup> *Id.*

<sup>26</sup> *See* *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 404–09 (1911).

<sup>27</sup> *Monsanto*, 465 U.S. at 762–63.

<sup>28</sup> *Id.* at 763.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 764.

<sup>31</sup> *Id.*

<sup>32</sup> 485 U.S. 717, 726 (1988).

<sup>33</sup> *See, e.g.*, *E. States Retail Lumber Dealers' Ass'n v. United States*, 234 U.S. 600 (1914); *Fashion Originators' Guild of Am., Inc. v. FTC*, 312 U.S. 457 (1941).

<sup>34</sup> *United States v. Gen. Motors Corp.*, 384 U.S. 127, 140 (1966).

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the *GTE Sylvania* lens, these cases—none of which involves the legality of any vertical restriction imposed by the manufacturer—become vertical restraints simply because the act implementing the restraint (the supplier terminating the price cutter) comes from above. Of course, action by an actor above or below the boycott victim is exactly how the classic group boycott works. Regarding the irrelevance of vertical restraints analysis in this setting, Justice Stevens noted in his dissent in *Business Electronics*:

In its opinion the majority assumes, without analysis, that the question presented by this case concerns the legality of a “vertical nonprice restraint.” As I shall demonstrate, the restraint that results when one or more dealers threaten to boycott a manufacturer unless it terminates its relationship with a price-cutting retailer is more properly viewed as a “horizontal restraint.” Moreover, an agreement to terminate a dealer because of its price cutting is most certainly not a “nonprice restraint.” The distinction between “vertical nonprice restraints” and “vertical price restraints,” on which the majority focuses its attention, is therefore quite irrelevant to the outcome of this case. Of much greater importance is the distinction between “naked restraints” and “ancillary restraints”. . . .<sup>35</sup>

**Abrogation of the Jury Function.** Before *Monsanto*, courts were split concerning the amount of evidence necessary to support a jury inference of conspiracy in a dealer termination case. In *Monsanto*, the Court adopted the Third Circuit’s majority opinion in *Edward J. Sweeney & Son, Inc. v. Texaco, Inc.*<sup>36</sup> In *Sweeney*, Judge Sloviter, in dissent, highlighted the two errors of the *Sweeney* majority, and thus *Monsanto*: (1) its unduly restrictive test for proof of conspiracy, and (2) its abrogation of the jury function.

On the first issue, Judge Sloviter noted that the case law is “replete” with price-motivated dealer terminations, and that

[U]ntil now, there has not been any serious question in this circuit that the competitors’ complaints to the supplier about the discounter’s market behavior and the supplier’s action in response thereto are sufficient to constitute the “combination” necessary to bring the matter within the scope of section 1 of the Sherman Act.<sup>37</sup>

Judge Sloviter then noted that the majority’s contrary holding was unsupported by any authority and that other courts had taken a more realistic view of the effect of reactions by suppliers to dealer price complaints.<sup>38</sup> In her view, case law long had “established that action which on the surface appears to be unilateral behavior can be considered to be part of a combination when viewed in light of the surrounding circumstances.”<sup>39</sup>

On the second issue, Judge Sloviter, after reviewing the evidence, concluded that a jury could well find a conspiracy between *Texaco* and the complaining dealers but that the court had usurped the jury’s fact finding function noting

The pertinent issue, of course, is not what the majority deems to be the reasonable inferences that can be drawn from the testimony but what the jury believes to be the reasonable inferences that can be drawn from the testimony . . . .

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<sup>35</sup> *Business Electronics*, 485 U.S. at 736 (Stevens, J., dissenting).

<sup>36</sup> 637 F.2d 105 (3d Cir. 1980).

<sup>37</sup> *Id.* at 124 (Sloviter, J., dissenting) (footnote omitted).

<sup>38</sup> *Id.* at 124–25.

<sup>39</sup> *Id.* at 125.

Although the majority purports to take cognizance of the difficulty of proving an antitrust conspiracy by direct evidence, the effect of its decision will be to require nothing less than direct evidence of a causal connection between Sweeney's competitors' complaints and Texaco's actions.<sup>40</sup>

*Business Electronics* provides a classic illustration of this effect of the *Monsanto/Sweeney* rule. At trial, after hearing several days of testimony, the jury concluded that Sharp's defense that it had terminated Business Electronics for poor sales performance was "pretextual."<sup>41</sup> Although the accuracy of this conclusion was unchallenged, Justice Stevens noted that

Nevertheless, the rule the majority fashions today is based largely on its concern that in other cases juries will be unable to tell the difference between truthful and pretextual defenses. Thus, it opines that "even a manufacturer that agrees with one dealer to terminate another for failure to provide contractually-obligated services, exposes itself to the highly plausible claim that its real motivation was to terminate a price cutter." But such a "plausible" concern in a hypothetical case that is so different from this one should not be given greater weight than facts that can be established by hard evidence. If a dealer has, in fact, failed to provide contractually obligated services, and if the manufacturer has, in fact, terminated the dealer for that reason, both of those objective facts should be provable by admissible evidence. Both in its disposition of this case and in its attempt to justify a new approach to agreements to eliminate price competition, the majority exhibits little confidence in the judicial process as a means of ascertaining the truth.<sup>42</sup>

**Definition of Price Fixing.** In addition to the errors outlined above, *Business Electronics* introduces yet another error into modern antitrust jurisprudence—its holding that the illegality of a price-fixing arrangement depends upon the conspirators' agreement to set prices at a particular level. This holding is unprecedented in antitrust law and directly undermines perhaps the most important of all Sherman Act cases, *United States v. Socony-Vacuum Oil Co.*,<sup>43</sup> which holds that price fixing is illegal *per se* and includes any conduct that has the purpose and effect of restraining price movement and the free interplay of market forces. As noted by the Court in *Socony-Vacuum*:

[A]ny combination which tampers with price structures is engaged in an unlawful activity. . . . [It is not] important that the prices paid by the combination were not fixed in the sense that they were uniform and inflexible. Price-fixing . . . has no such limited meaning. An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements to raise or lower prices whatever machinery for price-fixing was used . . . . Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.<sup>44</sup>

It is clear that the coercive dealer terminations involved in *Monsanto* and its ilk constitute horizontal price fixing in the classic sense. The sole purpose of the arrangement is to eliminate price competition of a competitor of one or more of the conspirators, who are then able to charge a higher price. Clearly, this is concerted "tamper[ing] with price structure" and "interfer[ing] with the setting of price by market forces." Yet the combination of *GTE Sylvania*, *Monsanto*, and *Business Electronics* virtually insulates this conduct from antitrust scrutiny.

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<sup>40</sup> *Id.* at 126–128.

<sup>41</sup> *Business Electronics*, 485 U.S. at 751 (Stevens, J., dissenting) (footnotes and internal citations omitted).

<sup>42</sup> *Id.* at 751–52 (Stevens, J., dissenting) (footnotes and internal citations omitted).

<sup>43</sup> 310 U.S. 150 (1940).

<sup>44</sup> *Id.* at 221–23.

## Vertical Maximum Price Fixing

*Schwinn* excepted, no pre-*Sylvania* antitrust case is more reviled than *Albrecht v. Herald Co.*,<sup>45</sup> which holds that vertical maximum price fixing is illegal per se. Judge Posner spoke of its “wobbly, moth-eaten foundations”<sup>46</sup> in his successful invitation to the Supreme Court to overrule *Albrecht* in *State Oil Co. v. Khan*.<sup>47</sup> As I have demonstrated at length on two other occasions,<sup>48</sup> the only thing wobbly and moth-eaten in the maximum vertical price fixing area is the voluminous Chicago School criticism of the *Albrecht* holding.<sup>49</sup>

*Albrecht* is one of only three maximum vertical price-fixing cases decided by the Supreme Court before *State Oil: Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*<sup>50</sup>; *Altbrecht*; and *Atlantic Richfield Co. (ARCO) v. USA Petroleum Co.*<sup>51</sup> *Kiefer-Stewart* was an attempt by liquor suppliers to control downstream liquor prices charged by an alleged wholesaler cartel after Office of Price Administration (OPA) price controls were lifted. *Albrecht* was an attempt by a newspaper to control price gouging by newspaper distributors it had established in exclusive territories. *ARCO* involved an attempt by an oil company to destroy independent retail competition by maintaining its dealers’ prices at artificially low levels.

Both *Kiefer-Stewart* and *Albrecht* were treated by the Court as straightforward price-fixing cases governed by *Socony-Vacuum Oil Co.*<sup>52</sup> Despite this fact, *Albrecht* was for decades criticized, and ultimately overruled based on three grounds: (1) control of successive monopoly, (2) the specter of vertical integration; and (3) the “*Schwinn*” connection. As summarized below, none of these arguments withstand scrutiny.

**Control of Successive Monopoly.** Virtually all *Albrecht* criticism is based upon the “control of successive monopoly” economic paradigm. Under this paradigm, monopoly exists at two stages of a product’s distribution (for example, manufacturing and distribution), resulting in higher prices and lower output than if only the manufacturing stage is monopolized. Critics assert that *Albrecht*’s maximum price-fixing rule is wrong because it eliminates an important tool for control of successive monopoly.<sup>53</sup> Although this theory may be defensible as a matter of economic theory, it is irrelevant as a basis for rejecting the *Albrecht* rule. Simply stated, neither *Albrecht*, nor any of the other three Supreme Court vertical maximum price-fixing cases involves successive monopoly or, indeed, any monopoly.<sup>54</sup> In fact, “[m]aximum vertical price fixing as condemned by *Albrecht* inevitably involves a supplier’s exercise of power over its downstream dealers.”<sup>55</sup> In this setting,

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<sup>45</sup> 390 U.S. 145 (1968).

<sup>46</sup> *Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996).

<sup>47</sup> 522 U.S. 3 (1997).

<sup>48</sup> See Roszkowski, *Albrecht*, *supra* note 8; Roszkowski, *State Oil*, *supra* note 8.

<sup>49</sup> See Roszkowski, *State Oil*, *supra* note 8, at 614 n.6.

<sup>50</sup> 340 U.S. 211 (1951).

<sup>51</sup> 495 U.S. 328 (1990).

<sup>52</sup> 310 U.S. 150 (1940).

<sup>53</sup> See Roszkowski, *Albrecht*, *supra* note 8, at 214 n.38.

<sup>54</sup> For additional discussion of this issue, see Roszkowski, *State Oil*, *supra* note 8, at 622–24.

<sup>55</sup> Brief for Service Station Dealers of America, at 7, *State Oil v. Khan*, 522 U.S. 3 (1997) (No. 96-871). Judge Posner admits this fact in the court of appeals opinion in *State Oil*, noting that a supplier without such power “cannot squeeze his dealers’ margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier.” *Khan v. State Oil Co.*, 93 F.3d 1358, 1362 (7th Cir. 1996). What Judge Posner fails to note is the more common option for the squeezed supplier, going out of business altogether.

vertical maximum price fixing facilitates imposition of a price-cost squeeze on dealers with significant potential for anticompetitive effect.<sup>56</sup>

**Specter of Vertical Integration.** Another argument used to attack *Albrecht* (and also to justify eliminating antitrust scrutiny of any vertical restraint, price or nonprice) is the specter of vertical integration. Here, this argument asserts that if suppliers are unable to use maximum price fixing to control downstream price gouging, “it creates perverse incentives for manufacturers to integrate vertically into distribution to the detriment of dealers.”<sup>57</sup> This argument is indeed surprising given the voluminous Chicago School commentary on vertical integration, either by new entry or merger, which is virtually uniform in its praise of (or at least lack of antitrust concern for) the practice.<sup>58</sup> The Chicago School approach to vertical integration is of course consistent with its modern vertical restraints law, which elevates supplier over small dealer interest and permits suppliers to direct downstream competition by controlling the retail dealer’s prices, territories, locations, and customers. It is clear that the “specter of vertical integration” argument is used here only to support an otherwise weak argument for rejecting *Albrecht*.

**The Schwinn Connection.** Certainly the flimsiest anti-*Albrecht* argument is the *Schwinn* connection, which asserts that: (1) *Albrecht* is based upon *United States v. Arnold, Schwinn & Co.*,<sup>59</sup> which held that nonprice vertical restrictions imposed in conjunction with a sale of goods are per se illegal; (2) *GTE Sylvania* overruled *Schwinn*; and (3) therefore *Albrecht* is no longer good law because it is based on the assumption that the exclusive territories granted by the newspaper were per se illegal under *Schwinn*. The only problem with this argument, which figures prominently in *Albrecht* criticism and *State Oil*, is that *Albrecht* is not based on *Schwinn*. In *Albrecht*, the Supreme Court was reviewing the Eighth Circuit Court of Appeals’ decision, which affirmed the district court’s judgment for the newspaper. The court of appeals’ decision was rendered on October 20, 1966, almost eight months before *Schwinn* was decided on June 12, 1967. Nonprice vertical restraints law at the time of the *Albrecht* lower court decisions was governed by *White Motor Co. v. United States*,<sup>60</sup> which (for lack of information about competitive impact) declined to announce a special standard for such restraints. Thus, nonprice vertical restraints law was at the time governed by the rule of reason, the same standard that now applies (at least in name) under *GTE Sylvania*.

The applicable nonprice vertical restraint standard was, in any event, irrelevant in the lower courts because the legality of the exclusive franchises was not at issue. Rather, the sole basis of the court of appeals holding was that no “combination” had been created, rendering the newspaper’s action “completely unilateral,”<sup>61</sup> and therefore outside the scope of Section 1.

The Supreme Court disagreed, applying *United States v. Parke, Davis & Co.*<sup>62</sup> to find the existence of a combination.<sup>63</sup> Then, citing, inter alia, *United States v. Trenton Potteries Co.*<sup>64</sup> and

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<sup>56</sup> For discussion of these effects, see Roszkowski, *State Oil*, supra note 8, at 630–32 and authorities cited therein.

<sup>57</sup> Brief for Business Roundtable at 13, *State Oil v. Khan*, 522 U.S. 3 (1997) (No. 96-871).

<sup>58</sup> See Roszkowski, *Albrecht*, supra note 8, at 235 n.147.

<sup>59</sup> 388 U.S. 365 (1967).

<sup>60</sup> 372 U.S. 253 (1963).

<sup>61</sup> *Albrecht v. Herald Co.*, 367 F.2d 517, 523 (8th Cir. 1966).

<sup>62</sup> 362 U.S. 29 (1960).

<sup>63</sup> *Albrecht*, 390 U.S. at 150.

<sup>64</sup> 273 U.S. 392 (1927).

*United States v. Socony-Vacuum Oil Co.*,<sup>65</sup> the Court applied “the long accepted rule in Section 1 cases that resale price fixing is a per se violation of the law whether done by agreement or combination.”<sup>66</sup> The irrelevance of the *Schwinn* issue is made abundantly clear both by the Court in *Albrecht* (“neither the existence of exclusive territories nor the economic power they might place in the hands of the dealers was at issue before the jury”),<sup>67</sup> and by Justice Douglas in concurrence.<sup>68</sup> In sum, *Schwinn* has nothing to do with the *Albrecht* holding, and by overruling *Albrecht* in *State Oil* to recognize its first-ever exception to the per se rule against price fixing, the Court has undermined its most fundamental and important Sherman Act holding, *Socony-Vacuum*.

*Albrecht* critics also prefer to ignore another question presented by the *Albrecht* case: why did the distributors have the power to gouge their customers? The answer: because the supplier established them in exclusive territories. Thus, the presumptive illegality of the exclusive territories is apparent from the fact that price fixing is necessary to police them. This fact was clearly articulated by Justice White in *Albrecht*,<sup>69</sup> and has been echoed by other critics.<sup>70</sup> This fact is ignored by *Albrecht* critics because it undermines the legacy of *GTE Sylvania*, which finds such restraints procompetitive or competitively innocuous.

## Conclusion

A detailed examination of the antitrust regime created by *GTE Sylvania* and its progeny reveals a bankrupt shell that refuses to recognize and protect any of the myriad values traditionally associated with antitrust law.<sup>71</sup> All of the pillars of Chicago School vertical restraints law introduce unprecedented and wholly unsupported holdings into the law:

- *GTE Sylvania*—proven injury to competition in one market can be justified by purported benefits to competition in another market.
- *Monsanto*—proof of an antitrust conspiracy requires proof that excludes the possibility that the defendants were acting independently.

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<sup>65</sup> 310 U.S. 150 (1940).

<sup>66</sup> *Albrecht*, 390 U.S. at 151.

<sup>67</sup> *Id.* at 153.

<sup>68</sup> “Under our decisions the legality of exclusive territorial franchises in the newspaper distribution business would have to be tried as a factual issue; and that was not done here.” *Id.* at 155–56 (Douglas, J., concurring).

<sup>69</sup> Justice White stated that the exclusive territories could not be presumed valid and that “[t]he assertion that illegal price fixing is justified because it blunts the pernicious consequences of another distribution practice is unpersuasive,” and noted that if the economic effect of the exclusive territories established by the newspaper “was such that the public could be protected only by otherwise illegal price fixing itself injurious to the public, the entire scheme must fall under § 1 of the Sherman Act.” *Albrecht*, 390 U.S. at 153–54.

<sup>70</sup> As succinctly stated by Professor Harry First: “If the manufacturer is concerned about distributors exploiting the monopoly power which flows from assigned exclusive territories, the problem should be cured by looking at the extent of the territorial restraint rather than by permitting the imposition of an additional restraint.” Brief of the Association of the Bar of the City of New York, at 16 (dissenting statement of Harry First), *State Oil v. Khan*, 522 U.S. 3 (1997) (No. 96-871).

<sup>71</sup> As Professor Sullivan has noted:

If antitrust law is, then, to remain a system of law, not a system of applied economics, it must be responsive to values other than allocative efficiency . . . . And it must be open to influences other than economics. . . . Among the non-economic goals of antitrust, all quite tenable as policy objectives, are a preference for decentralization of economic power, reduction of the range within which private discretion may be exercised in matters materially affecting the welfare of others, enhancement of the opportunity for more people to exercise independently entrepreneurial impulses, and, most blatantly, a social preference for the small rather than the large . . . .

LAWRENCE A. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 11 (1977); see also Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1152–54 (1981) (antitrust laws designed to protect “competition as process,” reflected in distrust of private power, concern for consumers, and concern for entrepreneurs).

- *Business Electronics*—a price fixing agreement requires specific agreement on prices or price levels.
- *State Oil*—price fixing is not a per se violation of the Sherman Act.

As Justice Stevens noted in his dissent in *Business Electronics*, the “most troubling” consequence of current vertical restraints law is its “failure to attach any weight to the value of intrabrand competition.”<sup>72</sup> Though pre-*GTE Sylvania* case law, common sense, and many commentators<sup>73</sup> find significant value in intrabrand competition, its elimination is now justified by theoretical and likely nonexistent<sup>74</sup> purported benefits to interbrand competition.

The antitrust world created by *GTE Sylvania* is indeed a strange place in which horizontal price restraints become vertical nonprice restraints, concerted conduct becomes unilateral, and the facts of individual cases do not matter. Perhaps it is time to recognize that those who developed Sherman Act jurisprudence during its first eighty-seven years might have gotten it right, and that a return to pre-*Sylvania* values is necessary to restore the Sherman Act to its rightful place as the “Magna Carta of free enterprise.”<sup>75</sup> ●

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<sup>72</sup> *Business Electronics*, 485 U.S. at 748 (Stevens., J., dissenting).

<sup>73</sup> See Roszkowski, *State Oil*, *supra* note 8, at 634–36.

<sup>74</sup> See *supra* note 12.

<sup>75</sup> *United States v. Topco Assocs.*, 405 U.S. 596, 610 (1972).