No. 85-1910

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

BUSINESS ELECTRONICS CORPORATION,
Petitioner,

v.

SHARP ELECTRONICS CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT SHARP ELECTRONICS CORPORATION

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QUESTION PRESENTED

Should an alleged agreement between a supplier and a full service dealer to terminate a free riding discounter—which agreement does not restrict the pricing freedom of any dealer—be deemed a form of price fixing unlawful *per se* under the Sherman Act?

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COUNTERSTATEMENT OF THE CASE

Introduction

While the narrow issue in this case is the proper definition of vertical price fixing under section 1 of the Sherman Act, 15 U.S.C. § 1, this case also raises issues of immense practical importance in the marketplace. The Court's decision will determine whether a supplier is able to protect its distribution system from "free riders" who reap the benefits of the efforts, but assume none of the costs, of full service dealers who provide the advertising, promotional, educational and point-of-sale services needed to benefit the consumer and stimulate sales of the supplier's product.

In 1973, Sharp Electronics Corporation ("Sharp"),[1] a supplier of business equipment, terminated Business Electronics Corporation ("BEC") as a Sharp dealer in Houston. The termination came about because BEC was a free rider: it had no salespeople,

1. Pursuant to Rule 28.1 of the Supreme Court Rules, Sharp Electronics Corporation represents that its parent corporation is Sharp Corporation and that it has no subsidiaries or affiliates.

did no advertising, and engaged in no promotional or educational services to stimulate sales. Gilbert Hartwell, Sharp's other Houston dealer, did all of these things, but once Hartwell developed a customer, BEC would take the sale by using its lower costs to offer that customer a price no full service dealer like Hartwell could afford to meet. Hartwell eventually gave Sharp an ultimatum that unless BEC was terminated, Hartwell would resign as a Sharp dealer. It was only then that Sharp terminated BEC's dealership.

BEC maintains that Hartwell's ultimatum and Sharp's acquiescence in it were motivated by concerns over the low prices BEC's free riding enabled it to charge, and that its termination therefore constituted a *per se* illegal vertical price fixing agreement. BEC makes this claim even though it does not deny that it was free riding, and even though it did not allege that there was any agreement between Sharp and Hartwell as to the prices Hartwell would charge if BEC were terminated.

The United States Court of Appeals for the Fifth Circuit concluded that a supplier is entitled to protect its distribution system, and that terminating a free rider at the request of a competing dealer is not *per se* illegal, so long as there is no agreement between the supplier and the remaining dealer as to the prices the latter will charge after the termination. Pet. App. at 13a-14a.[2] It is this determination that BEC challenges.

The Parties And The Market

Respondent Sharp is the supplier of a wide variety of Sharp brand consumer and business products, including electronic calculators. Sharp distributes these products throughout the United States. Tr. 1324-25.[3]

In 1968, Kelton Ehrensberger became the sole authorized dealer for Sharp electronic calculators in the Houston, Texas

2. "Pet. App." refers to the Petition for Writ of Certiorari which contains the majority and concurring opinions of the court of appeals. These opinions are also reported in *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 780 F.2d 1212 (5th Cir. 1986), *cert. granted*, 107 S. Ct. 3182 (1987).

3. "Tr." refers to the trial transcript.

area. Tr. 58; 68-69. Ehrensberger subsequently incorporated BEC and continued the dealership under that name. Tr. 58-59.

When Ehrensberger became a Sharp dealer, electronic calculators were new in the market and were not the compact, familiar and inexpensive items they are today. Rather, these calculators were large, complicated products that were designed for use by commercial enterprises, and that sold at retail for up to $1,000 per unit. Tr. 59-61; 153; 342-43; 1106-07. Initially, electronic calculators competed with large, electro-mechanical calculating machines manufactured by established companies such as Monroe, Canon, Victor and Freiden. Tr. 356; 358-59.

Because electronic calculators were expensive, complex and unfamiliar, stimulating buyer interest required extensive promotional and educational efforts by both the supplier and the dealer. This was necessary, first, to convince the customer to buy an electronic calculator rather than the more familiar mechanical kind and, second, to enable the customer who decided to purchase an electronic calculator to determine which model would suit his particular needs. Typically, a dealer would have to make four or five sales calls on a single customer before that customer could be persuaded to place an order. Tr. 113-14; 343-48; 1429-32.

BEC did not emphasize the kind of pre-sale educational and promotional services that Sharp desired and that were necessary to stimulate consumer interest and effect sales. Instead, BEC's marketing strategy was to concentrate on discount prices. Tr. 72-73; 124-28. The net result of this strategy was that, by 1972, even though there was no other authorized Sharp dealer in the Houston area, BEC was falling woefully short of the quota assigned by Sharp, *see* Defendant's Trial Exhibit ("Def. Ex.") No. 26 (introduced and admitted at Tr. 700), and Sharp decided to terminate BEC's dealership.[4] Tr. 827-30; Tr. 700.

4. BEC contends it was the fact that it priced below Sharp's suggested list, not its poor performance, that led Sharp to this decision, and that the jury agreed with BEC's contention. Brief of Petitioner Business Electronics Corporation ("BEC Br.") at 3, 7, 11, 31. However, BEC ignores the fact that the district court erroneously excluded on hearsay grounds contemporaneous business records showing Sharp's pre-existing policy to terminate *all* dealers whose

(footnote continued on following page)

Having reached this decision, Sharp began negotiations with Gilbert Hartwell of Hartwell's Office World to see if he would become the Sharp electronic calculator dealer in Houston. Tr. 321-22. Hartwell accepted with the understanding that BEC was to be terminated, and that Hartwell would have the exclusive Sharp dealership in the Houston area. Tr. 322-24.

Sharp did not terminate BEC, however, because a new Sharp management team assumed responsibility for the distribution of electronic calculators and wanted time to study the market before finally deciding on Sharp's distribution system in Houston. Tr. 1307-08; *see also* Tr. 830-33. As a result, from 1972 on, Hartwell and BEC both functioned as Sharp electronic calculator dealers in the Houston area.

This was not satisfactory from Hartwell's standpoint. From the inception, he complained repeatedly to Sharp that he had been promised an exclusive dealership and that Sharp's refusal to terminate BEC constituted a breach of that promise. Tr. 272-73; 323. But notwithstanding its earlier assurances, Sharp refused to terminate BEC. Tr. 269.

BEC's retention might have been a bitter pill for Hartwell, but the Hartwell appointment yielded an unexpected dividend for BEC. BEC quickly discovered that it could profitably dispense with its own sales force and free ride on Hartwell's sales efforts. *See, e.g.*, Tr. 283-84; 346-48.

(footnote continued from previous page)
performance against quota was as poor as BEC's. Pet. App. at 15a-18a. These documents were so clear in their import, even the district court observed that if they were admitted:

> [T]hat's going to knock the plaintiff out of the suit. He couldn't win.
>
> . . . .
>
> I haven't seen anything in this case that's so damaging to the plaintiff as all these papers saying fire anybody—that's what they say—fire anybody who [does not] meet that standard.

Tr. 811; *accord, e.g.*, Tr. 798.

The court of appeals ruled that these documents must be admitted at a new trial. Pet. App. 15a-18a. BEC's assertions, then, as to what the jury found regarding Sharp's motivation in terminating BEC must be read in light of the fact that the jury was deprived of evidence crucial to Sharp's defense.

BEC was able to free ride because Hartwell ran a full service dealer operation. Hartwell advertised the Sharp product extensively and had a trained sales staff that would spend time with prospective customers discussing their needs, explaining the merits of the new electronic calculator, demonstrating different models of calculators and performing the other expensive pre-sale promotions and services necessary to generate interest in electronic calculators in general and in the Sharp model in particular. Tr. 343-44; 1031; 1102-03.

Before Hartwell became a dealer, BEC had to perform these services itself and bear the attendant costs if it was to make any sales. Tr. 112-114. Once Hartwell assumed this burden, however, BEC dispensed with its entire sales force, stopped advertising, and let Hartwell's salespeople educate prospective customers at Hartwell's expense. When a customer was convinced that he should purchase an electronic calculator and knew what model would fit his needs, BEC would procure the sale by a flier offering that very customer a price so low that Hartwell, a full service dealer with expenses for advertising and salespeople salaries, could not possibly meet it. Tr. 110; 279-80; 283-84; 343-44; 346-48.

Recognizing that he was subsidizing BEC's sales and in effect competing against himself, Hartwell complained bitterly to Sharp. Tr. 279-80. Hartwell stated that he did not care what BEC charged to customers BEC developed on its own, but Hartwell did not want to see customers that he had discovered and educated snatched away because BEC, with no sales staff and service costs, could offer a much lower price:

> Q. So, when you talked yesterday about your unhappiness about Mr. Ehrensberger's discounting or price cutting what was it exactly that you were upset about, was it the fact that he was selling calculators at below list price?
>
> A. No.
>
> Q. What was it?
>
> A. It was the fact we were working the deal, doing all the work and we weren't getting any of the profit. We

were going off—Mr. Ehrensberger's flier just cut your legs out from under you. We did all the legwork, all the selling and one little piece of flier came in and they are ready to buy the same product from him.

Q. Did you care what price Mr. Ehrensberger offered to customers that he developed?

A. I could care less.

Tr. 347-48; *accord, e.g.*, Tr. 284.

Sharp responded to Hartwell's complaints by saying that it believed there was simply nothing it could do to restrict BEC's ability to sell as it wanted, at whatever price it wanted. In fact, Hartwell complained that all he ever heard from Sharp was "the same broken record, that a manufacturer could not tell a dealer what to sell his product for[.] [N]o matter who I talked to.... I heard that over and over." Tr. 366; *accord, e.g.,* Tr. 351-53; 363-65; 366-67; 867-68; 918-22.

Therefore, in June 1973 Hartwell presented an ultimatum: if Sharp wanted to retain Hartwell as a dealer, it would have to be on the exclusive basis originally promised—within 30 days Sharp would have to terminate BEC or Hartwell. Tr. 367-72; 420; 441; *see also* Tr. 290.

From an objective business standpoint, this was not a difficult decision. Prior to 1972, when BEC serviced the Houston market alone, its performance was so dismal as to warrant termination under Sharp's pre-existing standards. Tr. 827-30; Def. Ex. No. 26 (introduced and admitted at Tr. 700); Tr. 199-200; *see also* Tr. 768; 773-74; 840-41; Def. Ex. No. 6 (introduced and admitted at Tr. 839-40). Even when Hartwell and BEC both functioned as dealers and BEC was able to free ride, Hartwell's performance had generally been superior. Tr. 844-45; Def. Ex. No. 108 (introduced and admitted at Tr. 843-44).

Most importantly, Hartwell had a professional sales staff to provide necessary services to potential customers. BEC no longer had any sales force, and without the ability to free ride upon a full service dealer like Hartwell, BEC would have no capacity whatsoever to service the territory. In view of the fact that Hartwell had a great deal more potential for future growth,

Sharp chose to retain Hartwell and terminated BEC's dealership. Tr. 371-74; 774-75; 842-45; 867; 1309. BEC then commenced suit.

Proceedings In The District Court

BEC acknowledged at trial that its *sole* claim was that it had been terminated pursuant to a vertical price fixing agreement between Sharp and Hartwell. Tr. 668-70. However, BEC did not maintain that either before or after its termination Sharp and Hartwell actually fixed prices. In other words, BEC did not contend that Sharp told Hartwell what prices to charge, nor did it contend that Hartwell ceded to Sharp any part of his discretion to price as he chose. Rather, BEC maintained that so long as Sharp terminated BEC because of its discounting, this was vertical price fixing and *per se* illegal:

> Mr. McGowan [counsel for BEC]: We do not—plaintiff; in this type of case, a vertical price fixing case, does not have to prove an agreement between Sharp and somebody else to fix retail prices to agree on specific prices. What we have to prove, your Honor, is there was an agreement to terminate the dealer because it was discounting....
>
> ....
>
> ...That's our theory, your Honor, that he was terminated at the request of Mr. Hartwell because he was discounting. Hartwell didn't like his price cutting, so he went to Sharp and asked he been *[sic]* terminated, Sharp agreed to, he was terminated.
>
> The Court: Is that the only theory you want me to present to the jury?
>
> Mr. McGowan: That's our theory, your Honor.

Tr. 668-69.

BEC's invention of a theory of vertical price fixing that did not require any proof of an agreement on price was a creature of necessity. The uncontroverted evidence at trial showed there was no agreement on prices or price levels. Tr. 327; 371-73; *reprinted* *in* J.A. 8-11; *see also* J.A. 12-13.[5] Hartwell testified that both before and after the termination he understood that he could sell at whatever prices he wanted, Tr. 332, he sold at whatever prices he wanted, Tr. 333, and he regularly sold at prices well below those recommended by Sharp. In Hartwell's words, he discounted on the sales of Sharp calculators virtually every day with no interference by Sharp, and after the BEC termination, the retail prices for Sharp calculators actually decreased. Tr. 294; 327; 342-43; 893-94; *see also* Tr. 1027-28; 1105.

The record also shows that interbrand competition in the relevant market was, and remains, fierce. During the time period here involved, some 100 competing brands of calculators were being sold, and there was never any suggestion at trial that Sharp had a significant share of any interbrand product market. Tr. 931. Moreover, during the ten year period prior to the trial, not only did Hartwell's prices decrease, but the average retail price of calculators also decreased substantially. Tr. 893-94; 931; 1024; 1027-28.[6]

The District Court's Instructions To The Jury

Since BEC charged Sharp with terminating BEC's dealership pursuant to a price fixing agreement, Sharp requested the district court to instruct the jury that to find a violation of section 1 of the Sherman Act, it would first have to find that Sharp and Hartwell had some agreement as to the prices or price levels Hartwell

5. "J.A." refers to the Joint Appendix.

6. BEC complains throughout its brief that Hartwell's gross profit margin increased after BEC's termination and that this is somehow evidence of *per se* illegal conduct. BEC Br. at 5 & n.3, 19, 43. But gross profit margin as defined in this case is simply the difference between the dealer's cost of purchase from the supplier and its sales price to the consumer. Tr. 381; BEC Br. at 5. It says nothing about the price paid by the consumer and, moreover, with respect to a full service dealer like Hartwell, who incurs substantial service and promotional expenses, it says nothing about the profits actually realized by the dealer.

If anything, the fact that Hartwell's gross profit margin increased after BEC's termination is perfectly illustrative of the proper operation of the marketplace. Uninhibited by free riding, a full service dealer is able to invest in more and better consumer services and recoup that investment through the necessary price adjustments to the consumer. *See infra* pp. 28-33.

would charge after the BEC termination. *See* J.A. 7 (Defendant's Requested Jury Instruction No. 23).

The district court refused to give this instruction, and over Sharp's objection, Tr. 1594-95; 1598-99, instructed the jury that:

> The Sherman Act is violated when a seller enters into an agreement or understanding with one of its dealers to terminate another dealer because of the other dealer's price cutting.

J.A. 18.

The district court also submitted a special interrogatory to the jury:

> Question Number 1 asks you whether you find by a preponderance of the evidence that there was an agreement or understanding between Sharp and Hartwell to terminate Business Electronics as a Sharp dealer because of Business Electronics' price cutting.

J.A. 16.

Sharp objected to this instruction because it did not require any finding of price fixing as a predicate for liability.[7] The jury answered "yes" to Question Number 1 and returned a verdict in favor of BEC in the amount of $600,000. Tr. 1614.

7. Amicus Curiae National Mass Retailing Institute ("NMRI") argues that this instruction substantially complied with Sharp's own Requested Jury Instruction No. 24. Brief Amicus Curiae of National Mass Retailing Institute in Support of Petitioner ("NMRI Br.") at 20-23. NMRI's argument ignores what the record makes obvious—that Sharp's Requested Jury Instruction No. 24 was intended to be given in tandem with its Requested Jury Instruction No. 23, which, as shown above, required that there be an agreement to fix or maintain resale prices at a certain level. Sharp made it clear that the two instructions were intended to be read together when it objected to the district court's proposal to charge the jury in accordance with BEC's theory. Tr. 1597-98. The best evidence of Sharp's intention in this regard is the fact that BEC, which was present at the trial, has itself not seen fit to raise this specious argument before either the court of appeals or this Court.

The Court Of Appeals Opinion

The court of appeals reversed. Pet. App. at 18a-19a. Relying on *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984), it concluded that BEC's theory of *per se* illegality would proscribe conduct of the kind permitted—indeed encouraged—by the antitrust laws:

> [T]he manufacturer which desires to terminate a price cutter because of its free riding will be deterred from this legitimate action because it is indistinguishable, except perhaps to a mind reader, from what [BEC maintains the law] prohibits, i.e., termination of a price cutter because of its price cutting.

Pet. App. at 12a.

Accordingly, the court of appeals held that the jury should have been required to find that BEC was terminated pursuant to a price maintenance agreement between Sharp and Hartwell before it was permitted to find a *per se* violation of section 1 of the Sherman Act. Pet. App. at 12a. The court did *not*, as BEC now claims, BEC Br. at 8-9, require an *express* finding that prices be fixed at a defined level. Rather, it held that no price fixing agreement could be said to exist unless the dealer ceded to the supplier its right to price at whatever level it chose in the exercise of its own independent business judgment:

> [I]n order for a manufacturer's termination of a distributor to be illegal *per se*, it must be pursuant to a price maintenance agreement with another distributor. That distributor must expressly or impliedly agree to set its prices at some level, though not a specific one. The distributor cannot retain complete freedom to set whatever price it chooses.

Pet. App. at 13a-14a. Because the jury instructions failed to reflect this standard, the court of appeals held them critically

defective, thus requiring reversal of the judgment.[8] Pet. App. at 13a-14a.

However, the court of appeals also found that even though Hartwell testified that he always priced at whatever level he wanted, the jury could infer that his pricing policies were in fact undertaken pursuant to a *per se* illegal resale price fixing agreement with Sharp, based on the fact that Hartwell frequently priced in conformity with Sharp's suggested list. Pet. App. at 15a. For this reason, the court remanded for a new trial under proper jury instructions. Pet. App. at 18a-19a.

Judge Jones concurred, but she stated that this case perfectly illustrates why all vertical restraints, including vertical price restraints, should be tested under the rule of reason. She therefore urged this Court to overturn the rule of *per se* illegality for vertical price restraints. Pet. App. at 19a, 23a.

INTRODUCTION AND SUMMARY OF ARGUMENT

BEC's argument in this Court is devoted largely to the proposition that price fixing is evil and that vertical price fixing agreements should therefore remain *per se* illegal. The primary issue in this case, however, is *not* whether vertical price fixing violates the antitrust laws, but whether a specific kind of agreement—a supplier's agreement to terminate a discounting dealer—constitutes vertical price fixing. BEC begs this question because the court of appeals' determination that such an agreement is not, of itself, *per se* illegal is demonstrably correct.

8. As noted above, *supra* note 4, the court of appeals also ruled that the district court improperly excluded evidence crucial to Sharp's defense. Pet. App. at 15a-18a. For this reason, BEC is wrong when it states that the district court's judgment should be reinstated. BEC Br. at 11. Even if BEC's jury instructions had not been critically defective, a new trial would have been required because of this improper exclusion of evidence.

I.

This Court consistently has held that the *per se* rule is reserved for a narrow category of practices that always or nearly always have a "pernicious effect on competition and lack of any redeeming virtue." *Northern Pacific Railway* v. *United States*, 356 U.S. 1, 5 (1958). BEC attempts to invoke the *per se* rule simply by labeling Sharp's conduct as pernicious, without engaging in any meaningful effort to analyze its effects on competition. However, *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977), establishes that most supplier-dealer agreements—even those that increase resale prices—are pro-competitive in nature. They can be used to encourage dealers to make an investment in the supplier's product and provide expensive promotion, education and other customer services that benefit the consumer and stimulate sales of the supplier's product. Thus, they should not be summarily condemned.

Economic analysis confirms that the specific conduct at issue here—the termination of a discounting dealer who undermines a supplier's product distribution system by engaging in free riding—serves to enhance efficiency and to stimulate interbrand competition. Efficient and pro-competitive product distribution depends on efforts by dealers to provide a variety of services, such as consumer education and product demonstration. Too frequently, discounting dealers do not provide these services, even when they are required for an effective distribution system. Instead, as the evidence in this case illustrates, these dealers will "free ride" on the efforts of responsible dealers who do provide these services; that is, they will wait until another dealer, at his own expense, stimulates consumer demand and then use their lower sales costs to undercut the full service dealer's prices and steal the sale.

This Court reaffirmed in *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984), that a vertical price fixing agreement does not exist simply because a particular practice may affect resale prices. Rather, *Monsanto* holds that such an agreement exists only where a dealer cedes its right to price in accordance with its independent business judgment and agrees to charge a price dictated by the supplier. A supplier's agreement to terminate a free riding dealer says nothing about what prices the remaining dealer will charge. Thus, the court below properly concluded that the jury was erroneously instructed on the elements of a *per se* violation of section 1 of the Sherman Act when the district court charged that an agreement to terminate a discounting dealer, standing alone, violates section 1.

II.

BEC proposes that the law be changed, and that all agreements to terminate discounters, even absent any agreement on prices between the supplier and the remaining dealer, be deemed *per se* illegal. Since free riders are, by definition, discounters, BEC's rule would make it a virtual certainty that a jury verdict in favor of the terminated dealer must be returned, even where, as in this case, the supplier has done nothing more than or different from that which is permitted by *Sylvania*.

Sylvania recognizes that a system of pro-competitive vertical restraints cannot be achieved unless the supplier is free to limit its distribution system by, for example, providing one dealer with an exclusive territory. BEC offers no rationale for making a supplier's decision to terminate a free riding dealer *per se* illegal even though a decision to grant an exclusive dealership—which would accomplish the same economic purpose and effect—is not.

The reason that BEC makes no attempt to examine the economic purpose or effect of agreements such as the one at issue is because this examination would show that agreements to terminate a discounter are not inherently anticompetitive. To the contrary, they are generally valuable competitive tools, particularly where a supplier's efficient distribution system is threatened by a free rider. Such agreements should not be deemed illegal *per se* without any consideration of their beneficial effects on interbrand competition in the marketplace.

III.

Finally, the judgment below may also be affirmed on the ground that vertical price restraints, like all other vertical restraints, should be subject to the rule of reason. Vertical price restraints have precisely the same pro-competitive features as non-price vertical restraints. They can be used to promote dealer services by ensuring that the dealer will be able to charge a price high enough to recoup his investment in those services. At the same time, built-in marketplace checks—most importantly, the presence of interbrand competition—minimize any risk that such restraints will have an adverse effect on competition. Moreover, in many circumstances, non-price vertical restraints will not be an effective means of dealing with a free rider problem; only a resale price maintenance agreement will work.

In order to ensure a rational body of antitrust law and curtail the ever-swelling flow of dealer termination cases, vertical price restraints should be reviewed under the same standard as vertical non-price restraints, that is, they should be subject to the rule of reason.

ARGUMENT

POINT I

AN AGREEMENT BETWEEN A SUPPLIER AND A DEALER TO TERMINATE A COMPETING DEALER BECAUSE OF ITS DISCOUNTING IS NOT *PER SE* ILLEGAL ABSENT AN AGREEMENT ON PRICE

A. A *Per Se* Illegal Vertical Price Fixing Agreement Exists Only If There Is A Supplier-Dealer Agreement on Price

Under *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977), only vertical price fixing agreements are *per se* illegal. All other vertical restraints are tested by the rule of reason, which measures the actual market impact of an alleged restraint in the individual circumstances of the case.

At trial, BEC did not try to prove a rule of reason case. BEC could not do so because the factual record in this case shows that all the benefits of healthy competition—more competing brands, better product mix, lower prices—have been fully realized in the electronic calculator market that Sharp served. *See* Pet. App. at 19a-23a.

Recognizing that it can prevail only if it established a *per se* claim, BEC maintains that the court of appeals radically re-wrote the antitrust laws in holding that an agreement between a supplier and one of its dealers to terminate a discounting dealer is not, of itself, a price fixing agreement. According to BEC, it was a "novel departure from the standard of *per se* illegality" for the court below to hold that proof of a supplier-dealer agreement to set resale prices was an integral element of a *per se* illegal vertical price fixing agreement. BEC Br. at 11. BEC contends that this Court's decisions establish that *any* agreement intended to reduce or eliminate price competition constitutes price fixing, even if no agreement on prices exists. BEC Br. at 9-11, 12, 15-19, 21.

BEC is incorrect. This Court has recognized that supplier-dealer agreements frequently stimulate interbrand competition and that a vague or overbroad definition of vertical price fixing—of the type proposed by BEC—is likely to deter pro-competitive conduct. *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 762-64 (1984).[9] Accordingly, this Court has always employed the careful, focused definition of price fixing followed by the court below. It has applied the *per se* rule only when the evidence showed that a dealer had ceded his right to price independently:

> This Court has applied the *per se* rule against resale price maintenance only to situations in which the evidence showed that the manufacturer or wholesaler "dictat[ed] the prices charged by" a wholesaler or retailer. *California Retail Liquor Dealers Ass'n* v. *Midcal Aluminum, Inc.*, 445 U.S. [97,] 103 [(1980)]....

Brief for the United States as Amicus Curiae on BEC's Petition and Sharp's Cross-Petition for Writ of Certiorari (hereinafter cited as "U.S. Br.") at 8 (approving the analysis of the court of appeals) (additional citations omitted). *Accord United States* v. *A. Schrader's Son, Inc.*, 252 U.S. 85, 99 (1920) (recognizing the "obvious difference between the situation presented when a manufacturer merely indicates his wishes concerning prices ... and one where he enters into agreements which undertake to bind [dealers] to observe fixed resale prices").[10]

9. Even in the horizontal context, this Court has counseled against application of the *per se* rule based upon an overbroad definition of price fixing, stating that much conduct that could fall within a literal and overly simplistic definition of the term is conduct that should not be summarily condemned under section 1 of the Sherman Act. *Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1, 8-10 (1979).

10. This standard has been applied by numerous lower courts as well. *See, e.g., AAA Liquors, Inc.* v. *Joseph E. Seagram & Sons, Inc.*, 705 F.2d 1203, 1205-06 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983); *Muenster Butane, Inc.* v. *Stewart Co.*, 651 F.2d 292, 295-96 (5th Cir. 1981); *Borger* v. *Yamaha Int'l Corp.*, 625 F.2d 390, 397 (2d Cir. 1980) (reversing jury verdict of *per se* liability based on jury instruction substantially identical to BEC's); *Chisholm Bros. Farm Equip. Co.* v. *International Harvester Co.*, 498 F.2d 1137, 1142 (9th Cir.) ("The crux of any price-fixing agreement is the relinquishment by a trader ... of the freedom to set prices in accordance with his own judgment."), *cert. denied*, 419 U.S. 1023 (1974).

BEC attempts to harmonize its argument with this established precedent by asserting that the only purpose and effect of a supplier's agreement to terminate a discounter is to permit the remaining dealer to raise its prices. Indeed, BEC goes so far as to argue that termination in these circumstances necessarily implies that the remaining dealer has agreed to charge a price higher than that of the terminated dealer, and that it is illogical to believe that the dealer whose complaints led to the termination of a discounting competitor will then start to discount himself. BEC Br. at 9-10; 19-21; 43.

These arguments are facile, but they do not withstand scrutiny. A supplier's termination of a discounting dealer may be done for a variety of reasons wholly unrelated to control of the remaining dealer's prices. For example, it may be done to provide the remaining dealer with an exclusive territory or to avoid a free riding problem—reasons that are perfectly lawful and economically beneficial and that, absent an actual agreement on prices, should not be interdicted by section 1 of the Sherman Act. *Monsanto*, 465 U.S. at 762-64; *Sylvania*, 433 U.S. at 54-57; *Valley Liquors, Inc.* v. *Renfield Importers, Ltd.*, 822 F.2d 656, 663-64 (7th Cir. 1987). Thus, contrary to BEC's principal submission, the circumstance of termination of a discounter standing alone cannot be equated with an effort on the supplier's part to control its dealer's prices.

Moreover, contrary to BEC's secondary argument, it is perfectly normal for a dealer who complains about another dealer's discounting to continue discounting after the latter's termination. In fact, that is precisely what Hartwell did here. Tr. 294; 327; 332; 333; 342-43; 893-94; 1027-28; 1105. *See also Valley Liquors*, 822 F.2d at 662. This is simply because an agreement to terminate a discounter says nothing about any price agreement between the supplier and the remaining dealer.

Accordingly, to infer an agreement to fix prices from the mere circumstance of an agreement to terminate a discounter, with no evidence that anyone ever charged a price dictated by the supplier, would be to find price fixing by speculation. This would constitute a perversion, rather than a proper application, of section 1. *Monsanto*, 465 U.S. at 763-64; *Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 1361-62 (1986).

This point is also confirmed by the very decisions upon which BEC purports to rely. For example, in *United States* v. *Parke, Davis & Co.*, 362 U.S. 29, 43 (1960), *cited in* BEC Br. at 9, 13 n.6, 16-18, 22, this Court held that absent direct evidence of an agreement on prices, plaintiff must be able to show, at a minimum, that remaining dealers charged a price directed by the supplier, or no vertical price fixing agreement can be inferred. As the court in *Yentsch* v. *Texaco, Inc.*, 630 F.2d 46 (2d Cir. 1980), summarized the rule flowing from *Parke, Davis* and *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968):

> The required combination must be demonstrated, then, by proof of (1) an express or implied agreement, or (2) the securing of actual adherence to prices by means beyond mere refusal to deal. . . .Thus, [plaintiff] might satisfy the [test] by proving either that *he* complied with [defendant's] price policy, or that the price policy (1) was firmly enforced, (2) applied to all service station dealers, and (3) was acquiesced in by most of them. Taken together, then, *Parke, Davis* and *Albrecht* stand for the basic proposition that use of coercion that achieves actual price-fixing is illegal.

Yentsch, 630 F.2d at 52.[11]

These critical elements of a vertical price fixing agreement—the requirement that the dealer cede his independence and enter into an actual agreement on prices with the supplier, as well as the requirement that remaining dealers adhere to the supplier's price demands—were synthesized by this Court in *Monsanto*.

11. BEC similarly distorts the holding of *United States* v. *Bausch & Lomb Optical Co.*, 321 U.S. 707, 721 (1944). *See* BEC Br. at 17. In *Bausch & Lomb*, this Court stated that a distributor of a trade-marked article may not lawfully limit the price at which its purchaser may resell by an agreement between the seller and purchaser to maintain resale prices. 321 U.S. at 721. The Court did *not*, as BEC suggests, hold that *per se* liability may be imposed absent a price fixing agreement.

Monsanto, like this case, involved a claim of price fixing predicated upon the fact that complaints from other dealers about plaintiff's discounting resulted in the supplier's termination of plaintiff. Remarkably, BEC asserts that *Monsanto* concerned only the question of what proof was required to establish concerted action sufficient under *United States* v. *Colgate & Co.*, 250 U.S 300 (1919), and not the distinction between *per se* illegal agreements on price and other types of concerted activity. BEC Br. at 23. BEC is wrong.

In *Monsanto*, this Court emphasized that a crucial distinction to be drawn "in distributor-termination cases is that between concerted action to set prices and concerted action on non-price restrictions." *Monsanto*, 465 U.S. at 761. The Court stated that vertical price fixing exists only if the evidence shows that the supplier "and some of its distributors were parties to an 'agreement' or 'conspiracy' to maintain resale prices and terminate price cutters." *Id.* at 765. The Court continued that if "there was evidence of an agreement with one or more distributors to maintain prices, the remaining question is whether the termination of [the price cutting distributor] was part of or pursuant to that agreement." *Id.* at 767. Finally, the Court stated that for plaintiff to prove the requisite agreement, it must demonstrate that "distributors are not making independent pricing decisions," *id.* at 762, and must show not only that the distributor conformed to the suggested price, but "that the distributor communicated its acquiescence or agreement [to the suggested price], and that this was sought by the manufacturer." *Id.* at 764 n.9.

The court of appeals correctly applied these principles in the instant case. The simple truth is that BEC did not present any evidence at trial with respect to the essential elements of a vertical price fixing agreement. BEC made no attempt to show that Hartwell ceded any of his ability to price independently. In fact, BEC expressly eschewed at trial any claim that Sharp and Hartwell entered into any agreement, direct or indirect, as to the prices Hartwell would charge after the BEC termination. Tr. 668-70.

In short, BEC failed to establish any of the elements that Monsanto requires for there to be a per se illegal price fixing agreement. Accordingly, the court of appeals' determination that no vertical price fixing agreement existed in this case was unquestionably correct. *See generally* U.S. Br. at 10-12 (agreeing with the court of appeals' analysis).

B. An Agreement Between A Single Supplier And A Single Dealer To Terminate A Competing Dealer Because Of Its Discounting Is Not A Horizontal Group Boycott

Having failed to show that a supplier's agreement to terminate a discounting dealer constitutes vertical price fixing, BEC attempts to avoid *Monsanto* by asserting that such an agreement can be viewed as a horizontal group boycott, *per se* illegal even absent evidence of price fixing. BEC Br. at 24-35.

BEC has come to its boycott theory late in the day. At trial, BEC explicitly stated that it was proceeding only on a vertical price fixing theory. Tr. at 668-70. BEC never sought an instruction to the jury based upon a horizontal group boycott theory, nor did it assert in the court of appeals that such a theory of liability constituted an alternative basis for affirming the district court judgment. Moreover, BEC did not raise this issue when it petitioned for certiorari. Accordingly, this segment of BEC's brief is not properly before the Court and should be disregarded. *See National Licorice Co.* v. *NLRB*, 309 U.S. 350, 357 n.2 (1940); Sup. Ct. R. 21.1(a); R. Stern, E. Gressman & S. Shapiro, Supreme Court Practice § 6.26, at 363-64 (6th ed. 1986).

In any event, BEC's horizontal group boycott argument is plainly wrong.

The instant case involves no horizontal element, only a single supplier-dealer agreement. A horizontal group boycott requires collaborative activity between two or more entities at the same level of competition. *Lomar Wholesale Grocery* v. *Dieter's Gourmet Foods*, 824 F.2d 582, 590 (8th Cir. 1987); *Westman Commission Co.* v. *Hobart International, Inc.*, 796 F.2d 1216, 1224 n.1 (10th Cir.), *petition for cert. filed*, 55 U.S.L.W. 3318

(U.S. Sept. 22, 1986) (No. 86-484); *Oreck Corp.* v. *Whirlpool Corp.*, 579 F.2d 126, 131 (2d Cir.), *cert. denied*, 439 U.S. 946 (1978). The cases cited by BEC illustrate this. For example, in *Klor's, Inc.* v. *Broadway-Hale Stores*, 359 U.S. 207 (1959), this Court applied the *per se* rule to a retailer's group boycott claim against a number of major appliance manufacturers and Broadway-Hale, a competing retailer. *Id.* at 212. The Court expressly distinguished the horizontal group boycott present in *Klor's* from a single supplier agreeing to give a single dealer an exclusive dealership agreement. *Id.* at 212-13. Similarly, in *United States* v. *General Motors Corp.*, 384 U.S. 127, 143-45 (1966), this Court found a *per se* illegal horizontal group boycott because a large number of dealers combined to pressure their common supplier not to sell to competing dealers.[12] Both before and after *Monsanto*, lower courts have specifically rejected the application of *Klor's* and *General Motors* to a dealer termination case of the kind here involved. *E.g.*, *Lomar Wholesale Grocery*, 824 F.2d at 590; *Oreck*, 579 F.2d at 131.

Every case in which a supplier terminates a dealer at the behest of another dealer would involve a horizontal group boycott as BEC defines that term. If proof of a price fixing agreement is not necessary to bring such cases within the *per se* rule, every plaintiff would simply say its termination was part of a horizontal group boycott instead of a price fixing conspiracy, and *Monsanto* would mean nothing.

To avoid this semantic gamesmanship, whether a dealer termination is posited as part of a vertical price fixing scheme or as part of a horizontal group boycott, the basic inquiry is the same. That inquiry is whether the *Monsanto* standard for *per se* liability in the vertical context—that there exists evidence of a supplier-dealer agreement to set prices—has been satisfied. Thus, in

12. In any event, under this Court's more recent decisions, it is doubtful even in a truly horizontal case that a *per se* analysis would be appropriate. An investigation of the purpose and market impact of horizontal boycotts is required, and only if the object of the boycott is *per se* illegal is the boycott so treated. *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 106 S. Ct. 2009, 2018-19 (1986); *Northwest Wholesale Stationers* v. *Pacific Stationery & Printing*, 472 U.S. 284, 298 (1985).

National Marine Electronic Distributors v. *Raytheon Co.*, 778 F.2d 190, 193 (4th Cir. 1985), where plaintiff also claimed that it was terminated at the behest of competing dealers, the court held:

> [I]n order to conspire to restrain retail price competition there must be some agreement to set, control, fix, maintain, or stabilize prices.... [W]hether one chooses to allege that the restraint is vertical or horizontal, the lack of a conspiracy to restrain prices leads to the same result. *Monsanto* bars National's claim.

Accord Lomar Wholesale Grocery, 824 F.2d at 590; *Valley Liquors*, 822 F.2d at 660 n.5 ("The actual label placed on the conspiracy is a 'pedantic distinction,' ... as the *Monsanto* standard applies regardless of which label is attached.") (citations omitted).

For these reasons, even if BEC's group boycott claim were not infirm for want of timely interposition, it should be rejected for a complete want of merit.

C. Post-*Monsanto* Decisional Law Makes Clear That An Agreement Between A Supplier And A Dealer To Terminate A Competing Dealer Because Of Its Discounting, However Denominated, Is Not *Per Se* Illegal Absent An Agreement On Price

Following *Monsanto*, *every* circuit in its most recent decision considering the issue has adopted the same rule applied by the court below. Each such circuit has held that there must be proof of an agreement to maintain resale prices—not merely an agreement between a supplier and a dealer that is "price related," or "price motivated," or that affects or reduces intrabrand price competition or eliminates a discounter—before there may be a finding of *per se* illegality:

> [A]s post-*Monsanto* authority recognizes, for a terminated dealer to prevail on its per se claim, the evidence must be sufficient for the jury to determine not merely that the manufacturer and nonterminated dealer conspired, but that they conspired to maintain resale prices.

McCabe's Furniture, Inc. v. *La-Z-Boy Chair Co.*, 798 F.2d 323, 329 (8th Cir.), *petition for cert. filed*, 55 U.S.L.W. 3495 (U.S. Dec. 29, 1986) (No. 86-1101). *Accord Lomar Wholesale Grocery*, 824 F.2d at 589; *Valley Liquors*, 822 F.2d at 662; *Garment District, Inc.* v. *Belk Stores Services, Inc.*, 799 F.2d 905, 911 (4th Cir.), *petition for cert. filed*, 55 U.S.L.W. 3476 (U.S. Nov. 17, 1986) (No. 86-794); *Westman Commission Co.* v. *Hobart International, Inc.*, 796 F.2d at 1222-24; *see also O.S.C. Corp.* v. *Apple Computer, Inc.*, 601 F. Supp. 1274, 1293-94 (C.D. Cal. 1985), *aff'd*, 792 F.2d 1464 (9th Cir. 1986); *Reborn Enterprises* v. *Fine Child, Inc.*, 590 F. Supp. 1423, 1439-40 (S.D.N.Y. 1984), *aff'd*, 754 F.2d 1072 (2d Cir. 1985).[13]

Pursuant to *Monsanto*, then, so long as the supplier does not secure an express or implied agreement from the remaining dealer as to the prices it will charge, there is no *per se* illegality.[14]

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13. These decisions dispose of the handful of pre-*Monsanto* cases which BEC claims adopted its theory that an agreement to terminate a discounting dealer constitutes a vertical price fixing agreement. *E.g.*, *Zidell Explorations, Inc.* v. *Conval Int'l, Ltd.*, 719 F.2d 1465 (9th Cir. 1983); *Cernuto, Inc.* v. *United Cabinet Corp.*, 595 F.2d 164 (3d Cir. 1979), *cited in* BEC Br. at 24-25. *But see Filco* v. *Amana Refrig'n, Inc.*, 709 F.2d 1257 (9th Cir.) (Ninth Circuit rule pre-*Monsanto* required proof of adherence to supplier's prices for vertical price fixing), *cert. dismissed*, 464 U.S. 956 (1983).

The only post-*Monsanto* cases BEC cites are *Jayco Sys.* v. *Savin Bus. Mach.*, 777 F.2d 306 (5th Cir. 1985), *cert. denied*, 107 S. Ct. 73 (1986), a Fifth Circuit decision rendered prior to the decision below, and two decisions from the Eighth Circuit, *Lomar Wholesale Grocery* and *Victorian House, Inc.* v. *Fisher Camuto Corp.*, 769 F.2d 466 (8th Cir. 1985). BEC Br. at 25-26. It is hard to tell what comfort BEC derives from these cases. In affirming summary judgment in favor of the supplier, the *Lomar* court indicated that the pre-*Monsanto* line of authority relied on by BEC was overruled by *Monsanto*, and that *Fisher Camuto* was viable only if it was read to mean that an actual agreement on prices is required to state a claim of *per se* illegality under section 1. *Lomar Wholesale Grocery*, 824 F.2d at 589-90, 592.

14. Subsequent to *Monsanto*, this rule was also adopted by the Antitrust Division of the United States Justice Department in its Vertical Restraints Guidelines. U.S. Dep't Justice, Vertical Restraints Guidelines at 10 (January 23, 1985), *reprinted in* 5 Trade Reg. Rep. (CCH) ¶ 50,473. Indeed, the Antitrust Division read *Monsanto* as requiring evidence of an explicit agreement on prices before a vertical price fixing agreement is established. *Id.*

(footnote continued on following page)

Even if BEC established that Sharp agreed to terminate its dealership because of BEC's discounting, this would not establish that Sharp dictated prices to Hartwell, or that Hartwell adhered to Sharp's prices, or that Hartwell ceded any of his ability to price in accordance with his own business judgment. The court of appeals was therefore correct in holding that the agreement alleged by BEC was not *per se* illegal.

POINT II

AN AGREEMENT BETWEEN A SUPPLIER AND A DEALER TO TERMINATE A DISCOUNTING DEALER FREQUENTLY HAS SIGNIFICANT PRO-COMPETITIVE VALUE AND SHOULD NOT BE SUBJECT TO *PER SE* ILLEGALITY

As shown above, an agreement between a supplier and a dealer to terminate another dealer because of its discounting does not fall within any established category of *per se* restraint. BEC's real complaint is that the court of appeals refused to create a new category of *per se* restraints encompassing such an agreement.

There was no error by the court of appeals in this regard. The normal test for illegality under section 1 of the Sherman Act is

(footnote continued from previous page)

BEC and its *amici* contend that Congress has criticized the Antitrust Division as attempting to extend the holding of *Monsanto*. BEC Br. at 37-38; NMRI Br. at 12-13; Brief of Amicus Curiae K Mart Corporation in Support of Petitioner at 17-18. Whatever intellectual interest may pertain to this debate between the executive and legislative branches, it need not be resolved in this case. As the United States pointed out in its brief at the certiorari stage:

> [T]he guidelines' definition of the *per se* rule is narrower than the definition adopted by the court of appeals .... Congress criticized that narrow rule (see § 605, 99 Stat. 1169); it did not express a view regarding the somewhat broader rule adopted by the court of appeals.

U.S. Br. at 11 n.12.

More to the point, not even BEC or its *amici*, which cite a plethora of Congressional statements and enactments they claim support BEC's position, go so far as to suggest that Congress supports a rule that termination of a free rider, without any proof of an agreement on resale prices, would constitute *per se* illegal price fixing. That, however, is the issue before this Court.

the rule of reason. The *per se* rule is employed only in those limited circumstances where courts have had considerable experience with the challenged conduct, and that experience shows the conduct consistently has a "pernicious effect on competition and lack[s] any redeeming virtue." *Northern Pacific Railway* v. *United States*, 356 U.S. 1, 5 (1958). If a restraint has even any arguable pro-competitive effect, the rule of reason should apply. *Sylvania*, 433 U.S. at 49-50.[15]

BEC's argument to expand the application of the *per se* rule is based on two distinct contentions. First, BEC asserts that because a horizontal agreement between two suppliers to eliminate discount price competition on the sales of their respective products would be *per se* illegal, a like rule is perforce appropriate in the vertical context. BEC Br. at 9, 13-14 n.6, 15, 18-19.[16]

BEC's second argument is that when a supplier agrees to eliminate a discounting dealer, this facilitates a price increase by the remaining dealer. BEC contends that any practice of a supplier that has the purpose or effect of raising its dealer's resale price is on its face pernicious and without redeeming value. BEC Br. at 10; 19-21.

15. In the decade since *Sylvania* overruled *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), and held all non-price vertical restraints subject to the rule of reason, this Court has consistently limited the scope of the *per se* rule, reaffirming that a market impact approach is the preferred method of analysis under section 1. *E.g., Northwest Wholesale Stationers* v. *Pacific Stationery & Printing*, 472 U.S. 284, 295-98 (1985) (horizontal group boycotts should not automatically be condemned *per se*; examination of market facts required); *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 26-29 (1984) (tying arrangements not necessarily *per se* illegal); *see also Broadcast Music, Inc.* v. CBS, 441 U.S. 1, 8-9 (1979).

16. Thus, BEC places heavy reliance on *Catalano, Inc.* v. *Target Sales*, 446 U.S. 643 (1980) (per curiam), *cited in* BEC Br. at 9, 16, 18-19, which held that an agreement among beer wholesalers to eliminate short-term trade credit previously granted to beer retailers constituted *per se* illegal price fixing. *Catalano*, 446 U.S. at 648. In so deciding, the Court stated that such "[a] horizontal agreement to fix prices is the archetypical example of [plainly anticompetitive] conduct," *id.* at 647, and further noted that the respondent wholesalers did not even attempt to "suggest a procompetitive justification for a horizontal agreement to fix credit." *Id.* at 646 n.8.

Although BEC proposes a novel *per se* rule, it does so without any supporting economic or legal analysis. Moreover, BEC ignores the extensive discussion of the competitive value of vertical restraints found in *Sylvania*, 433 U.S. at 53-58 and nn.22, 24-26, and *Monsanto*, 465 U.S. at 762-64. BEC ignores as well the wealth of antitrust commentary that specifically addresses whether a supplier-dealer agreement that reduces or eliminates intrabrand price competition should be summarily condemned. These analyses demonstrate that BEC's arguments are specious. Indeed, they conclusively demonstrate that an agreement of the kind BEC alleges has significant pro-competitive value in a wide variety of cases. Moreover, the new *per se* rule BEC proposes is unworkable and unwise. It would eliminate the objective standard of *Monsanto*, would permit a jury to find *per se* liability based upon speculation as to a supplier's motive, and would have a chilling effect on pro-competitive conduct.

A. *Sylvania* Establishes That Vertical Restraints Should Not Be Deemed *Per Se* Illegal Merely Because Similar Restraints Among Horizontal Competitors Are *Per Se* Illegal

BEC's first assertion—that the rule applicable to horizontal agreements to eliminate price competition should also apply in the vertical context—is an antitrust anachronism. The notion that a particular vertical practice should be deemed *per se* illegal just because a like practice among horizontal competitors would be *per se* illegal was appropriately discarded when this Court overruled *Schwinn* in *Sylvania*.

From an antitrust standpoint, horizontal and vertical agreements are fundamentally different creatures. Agreements among suppliers to eliminate price competition on their different brands of products serve no purpose but to limit output and increase prices. By reason of such an arrangement, a supplier can raise its wholesale price and make a higher profit even if it sells less product. While suppliers benefit from this arrangement, consumers pay a higher price and have fewer competing

products among which to choose. It is for this confluence of reasons that such horizontal agreements are condemned as *per se* injurious to competition. *See generally* U.S. Br. at 6-7.

By contrast, a vertical agreement benefits the supplier only if it increases the sales of the supplier's products. The supplier typically receives its payment from the dealer when the dealer makes its purchase from the supplier, not when the dealer resells the product, and the supplier's profit remains the same no matter what resale price the dealer charges. Not only does a supplier derive no benefit from an increase in its dealer's prices, but where there is significant interbrand competition, an artificially high price at the dealer level serves only to boost sales of competing products to the detriment of the supplier. *Sylvania*, 433 U.S. at 56 n.24 ("'Generally a [supplier] would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher [supplier] revenues.'") (citation omitted); *see generally* R. BORK, THE ANTITRUST PARADOX at 289-91 (1978).

The ordinary, foreseeable and only logical purpose, then, of supplier-dealer agreements is a pro-competitive one, that is, to increase the number of products the dealer buys and resells. For this reason, discussions between vertically aligned parties on prices, output and distribution systems—discussions that might well be deemed *per se* illegal in the horizontal context, *see United States* v. *Container Corp.*, 393 U.S. 333, 337 (1969)—are absolutely necessary. Rather than suppressing such discussions, the antitrust laws encourage them, because they lead to greater product availability to the ultimate consumer. *Monsanto*, 465 U.S. at 764 (to suppress such discussions would "create an irrational dislocation in the market."); *accord Lomar Wholesale Grocery* v. *Dieter's Gourmet Foods*, 824 F.2d 582, 593-94 (8th Cir. 1987); *Illinois Corporate Travel, Inc.* v. *American Airlines*, 806 F.2d 722, 726 (7th Cir. 1986) ("In any chain of distribution discussions of price will be frequent—and as *Monsanto* pointed out, beneficial too."); *see generally* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135 (1984).

BEC's attempt to predicate a *per se* rule for the vertical context on a horizontal analogy fails of its own weight.

B. Vertical Restraints Further Pro-Competitive Values Such As The Promotion Of Consumer Services And The Elimination Of Free Riding, And Therefore Should Not Be Deemed *Per Se* Illegal Even If They May Increase Resale Prices

BEC's second contention is that the antitrust laws should condemn agreements to terminate a discounter as *per se* illegal because they may lead to increases in the resale price of the supplier's product. This is another effort by BEC to turn the antitrust clock back to the days of *Schwinn.*

As this Court recognized in *Sylvania*, virtually all vertical restrictions have a tendency to increase prices at the dealer level. If the hallmark of *per se* illegality were the tendency of a restraint to facilitate a dealer price increase, there would be nothing left of *Sylvania* or *Monsanto. See, e.g.*, U.S. Br. at 11 ("Treating any reduction in price competition as justifying application of the per se rule would result in the application of the per se rule to virtually all vertical restraints, contrary to this Court's decisions in *Sylvania* and *Monsanto*.")[17]

Sylvania rejected BEC's argument because many vertical restraints simultaneously stimulate interbrand competition. 433 U.S. at 51-52. Often, the only way suppliers can persuade dealers to invest in their products and promote them vigorously against competing brands is if those dealers are able to charge prices that allow them to recapture their investment. *Id.* at 55. As the United States pointed out in this case:

> [T]o the extent that vertical restrictions succeed in encouraging dealer efforts, and thereby strengthen a product's competitive position, they do so precisely because they allow dealers to charge prices that cover the costs of providing the extra services that the manufacturer deems necessary for the efficient distribution of the product.

17. The fact that the *per se* rule against vertical price fixing is not premised upon a concern that prices may increase is shown by this Court's decision in *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968), holding that an agreement between a supplier and a dealer to set *maximum* prices is no less illegal than an agreement to set *minimum* prices.

U.S. Br. at 10 (footnote omitted). To say that a particular practice may lead to a higher resale price, then, is to say nothing about its purpose or overall effect on interbrand competition, the factors that are critical to determining whether the *per se* rule should apply. *Sylvania,* 433 U.S. at 54-59.

While BEC ignores these factors, courts have considered them in the context of the specific agreement at issue in this case—an agreement to terminate a discounting dealer. The conclusion has been that in most instances the purpose of such an agreement is *not* to permit a dealer to price-gouge—a practice that, as noted, would probably benefit no one and as an economic reality could not benefit the supplier. *See Sylvania*, 433 U.S. at 56 n.24. Rather, such an agreement is typically designed to further a pro-competitive end—the creation or protection of a distribution system that maximizes sales of the supplier's products against competing brands. *Monsanto,* 465 U.S. at 763-64; *Sylvania,* 433 U.S. at 54-56; *see also* Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171.

The pro-competitive nature of such an agreement follows from the fact that in many industries there is a need for pre-sale, point-of-sale or post-sale dealer services to stimulate demand for a product. *Sylvania*, 433 U.S. at 53-54. In some instances, the dealers will provide these services of their own accord. In many instances, however, even though these services are necessary to stimulate demand, they will be provided only if they are required by the supplier:

> Because of market imperfections such as the so-called "free rider" effect, these services might not be provided by [dealers] in a purely competitive situation, despite the fact that each [dealer's] benefit would be greater if all provided the services than if none did.

Sylvania, 433 U.S. at 55.

The present case well illustrates this "free rider" effect. One dealer, a Hartwell, appreciates the need for pre-sale promotion, education and other customer services if the supplier's product is to be sold, and he therefore makes the requisite investment in these services. A competing dealer, a BEC, realizes that these efforts will stimulate demand at no cost to it. Since the free rider has none of the full service dealer's selling expenses—no salespeople salaries, advertising or promotional costs—it can undercut the full service dealer's prices and take away the customers he has developed.

In the short run, such free riding means that some customers may be able to obtain a lower price on the supplier's product. In the long run, however, competition and the welfare of consumers suffer. A full service dealer cannot afford to maintain its level of services and meet the discounted free rider price *ad infinitum.* Ultimately, it must eliminate the services it was providing or abandon the market to the free rider. In either case, the pre-sale, point-of-sale and post-sale services necessary to educate the consumer and stimulate sales are lost, to the detriment of the supplier and the consumer alike. Cady, *Reasonable Rules and Rules of Reason: Vertical Restrictions on Distributors,* 46 J. MARKETING 27, 31-32 (1982); Bork, *Vertical Restraints: Schwinn Overruled,* 1977 SUP. CT. REV. at 181.

How to deal with the anticompetitive effects of free riding has become a seminal issue in contemporary antitrust law. Remarkably, but understandably, BEC is all but silent on this issue in its brief. This Court has not been silent, however. To the contrary, *Sylvania* first recognized and "*Monsanto* . . . resoundingly reaffirms the . . . centrality of free-rider concerns in fashioning antitrust rules . . . ." Popofsky & Bomse, *From Sylvania to Monsanto: no longer a "free ride",* 30 ANTITRUST BULL. 67, 93 (1985).

In order to promote dealer services (which not even BEC asserts are anti-competitive) and to prevent free riding (which not even BEC asserts is pro-competitive), the *Sylvania* and *Monsanto* decisions do two things. First, they recognize that the

supplier is ordinarily in the best position to determine how to market its products efficiently. Thus, they permit the supplier to require that dealers provide the pre-sale, point-of-sale or post-sale services which the supplier believes are necessary to promote the sale of its products. *Sylvania,* 433 U.S. at 55; *Monsanto,* 465 U.S. at 762-64.

Second, these decisions confirm that the supplier may take steps to ensure that dealers will agree to incur the additional costs these services entail. Specifically, the supplier may restrict intrabrand competition for the product, by, for example, providing the dealer with an exclusive territory. *Sylvania,* 433 U.S. at 55; *Monsanto,* 465 U.S. at 762-64.

This reduction in intrabrand competition may enable the dealer to charge a higher price on the supplier's product than if there were several dealers selling the same brand in competition with one another. However, it also provides the dealer with the economic incentive to furnish the services necessary to make the product competitive on an interbrand level. *Sylvania,* 433 U.S. at 54-55; Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality,* 48 U. CHI. L. REV. 6, 11 (1981).

Where the supplier finds that its dealers are not complying with its distribution requirements, it must be free to terminate those dealers. Otherwise, its right to structure a distribution system that maximizes the sale of its products is illusory. Indeed, this was precisely the fact pattern in *Sylvania.* There, the defendant manufacturer prescribed that dealers could only sell television sets from authorized locations. Consequently, each dealer had a territory insulated from intrabrand competition and could recover the costs it incurred in promoting the defendant's product. *Sylvania,* 433 U.S. at 38. When the plaintiff dealer violated the locations clause, its dealership was terminated. *Id.* at

39-40. This Court held that the locations clause, and the plaintiff's termination pursuant to that clause, should be evaluated under the rule of reason. *Id.* at 58-59.[18]

The supplier's general right to terminate dealers who disrupt its distribution system, recognized in *Sylvania*, has special application where the termination arises from the dealer's free riding. In such an instance, the supplier is acting not merely to preserve a distribution system that it views as efficient and pro-competitive, but to prevent a practice that this Court recognized has a corrosive effect on competition:

> The validity and legality of manufacturers' prevention of free riding . . . has been settled by the Supreme Court in *Monsanto* . . . and *Sylvania* . . . .

Local Beauty Supply v. *Lamaur, Inc.*, 787 F.2d 1197, 1202 n.2 (7th Cir. 1986); *see also* Popofsky and Bomse, *From Sylvania to Monsanto: no longer a "free ride"*, 30 ANTITRUST BULL. at 93-94.

Often, as in this case, the impetus for the termination comes from a full service dealer who is upset at the discount prices the free rider can offer by reason of its lower sales costs. *See, e.g.*, *Lomar Wholesale Grocery* v. *Dieter's Gourmet Foods*, 824 F.2d at 593-94; *Garment District, Inc.* v. *Belk Stores Services, Inc.*, 799 F.2d at 909-10. However, no matter where they originate, the concerns are legitimate and the effect of the termination is no different from the supplier's providing another dealer with a protected territory as in *Sylvania*. *See Monsanto*, 465 U.S. at 762. In both instances, the reduction in intrabrand competition enables the remaining dealer to provide the services necessary to stimulate consumer interest and compete more effectively in the interbrand market.[19]

18. On remand, the district court in *Sylvania* held the termination to be lawful under the rule of reason and dismissed the case; the court of appeals affirmed. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 461 F. Supp. 1046 (N.D. Cal. 1978), *aff'd*, 694 F.2d 1132 (9th Cir. 1982).

19. In fact, the territorial limitations authorized by *Sylvania* are more restrictive of intrabrand competition than a free rider termination. With a free

(footnote continued on following page)

Therefore, while an agreement to terminate a discounting dealer may lead to an increased resale price by the remaining dealer sufficient to cover the cost of necessary dealer-provided services, that is a pro-competitive effect, of benefit to suppliers and consumers alike. It is most unlikely to be the product of an anticompetitive motive by the supplier.

In addition, by reason of built-in checks in the marketplace, such an agreement is most unlikely to have any unreasonable effect on competition. In a market as competitive as electronic calculators, interbrand competition provides a strict check on the prices that even a full service dealer may charge. *See, e.g., Sylvania,* 433 U.S. at 52 n.19, 54. Finally, absent an agreement on prices, the full service dealer is still free to adjust its resale price as competitive circumstances dictate by, for example, discounting where necessary to make a particular sale if, in the dealer's independent judgment, such a course is desirable. *See, e.g., National Marine Electronic Distributors* v. *Raytheon Co.*, 778 F.2d 190, 193 (4th Cir. 1985) ("Raytheon did not require its dealers to sell at any fixed price. The dealers set their own retail prices, each taking into consideration its own cost of goods, overhead expenses, and a profit margin that was as much as the market would bear considering demand and competition.").

For these reasons, as the United States summed up at the certiorari stage in this case (U.S. Br. at 12):

> [A] vertical agreement to restrict intrabrand price competition by eliminating a discounting dealer—without prescribing the level of the remaining dealer's resale prices—may "'increase economic efficiency and render markets more, rather than less, competitive.'" *Northwest Wholesale Stationers, Inc.,* 472 U.S. at 295, quoting *Broadcast Music, Inc.*, 441 U.S. at 20. Such a restraint is therefore properly evaluated under the rule of reason.

(footnote continued from previous page)

rider termination, other dealers selling the supplier's product can still compete with the remaining dealer. When the supplier grants a protected exclusive territory, *all* intrabrand competition is eliminated.

C. To Subject A Supplier To *Per Se* Liability For Terminating A Free Riding Dealer Would Create An Irrational Dislocation In The Marketplace Of The Kind Warned Against In *Monsanto*

Perhaps the most troubling aspect of BEC's proposed new *per se* rule is the damage it would cause in the marketplace. Antitrust rules do not exist divorced from practical realities, *Sylvania*, 433 U.S. at 47, and, practically speaking, BEC's new *per se* rule makes no real world sense.

For example, BEC conveniently ignores the fact that its proposed rule of *per se* illegality would straightjacket the supplier who finds himself the unwelcome recipient of an "it's him or me" ultimatum. Just as complaints by a dealer to its supplier about another dealer's discount pricing are a normal and, from the supplier's standpoint, an unavoidable fact of life in the marketplace, *Monsanto*, 465 U.S. at 763, where a full service dealer is faced with a free rider problem, not only complaints, but ultimata of this kind are inevitable. *See, e.g., Belk Stores*, 799 F.2d at 910; *Raytheon*, 778 F.2d at 192.

BEC offers no suggestion as to what the rational supplier is supposed to do when faced with such an ultimatum. As the instant case illustrates, under BEC's rule, by terminating the free rider, even where necessary to avoid the interruption of an efficient distribution system which requires promotion and services, the supplier has placed itself in a position of enormous antitrust vulnerability.

If, however, the supplier ignores the ultimatum, and the full service dealer makes good on its threat and abandons the market to the free rider, the supplier's distribution system falls apart. No one will provide the promotional and educational services necessary to stimulate sales, to the detriment of both the supplier and the consumer. *Isaksen* v. *Vermont Castings, Inc.*, 825 F.2d 1158, 1161 (7th Cir. 1987). *See generally* Popofsky & Bomse, *From Sylvania to Monsanto; no longer a "free ride"*, 30 ANTITRUST BULL. at 89. There is no practical utility in a rule that requires a supplier to sacrifice its best dealers to protect a free rider. *Belk Stores*, 799 F.2d at 909-10. But that is precisely the rule that BEC proposes.[20]

D. BEC's Attempt to Distinguish This Case From the *Sylvania/Monsanto* Model On The Basis Of Sharp's Alleged Motive In Terminating BEC Highlights The Improvidence Of The New *Per Se* Rule That BEC Advocates

Although the record establishes that Sharp's conduct was the functional equivalent of its providing Hartwell with an exclusive dealership, BEC maintains that this case is distinguishable from the *Sylvania/Monsanto* model. BEC asserts that Sharp terminated BEC not because it wanted to provide Hartwell with an exclusive territory, and not because of BEC's free riding, but in furtherance of Hartwell's desire to eliminate BEC as a discounting rival. *E.g.*, BEC Br. at 7, 10-11. This, BEC argues, evidences the kind of naked anticompetitive conduct that should not be protected under a *Sylvania/Monsanto* analysis. BEC Br. at 22-24.

BEC's argument finds no support in the record. *See infra* p. 38. Even if it did, the argument would have no relevance to the question of whether a new *per se* rule is required. "*Per se* rules . . . require the Court to make broad generalizations about the social utility of particular commercial practices" and are not created to address one particular case. *Sylvania*, 433 U.S. at 50 n.16; *see also Lomar Wholesale Grocery*, 824 F.2d at 591. However, BEC's motive argument does serve a useful purpose. It

20. Indeed, the court in *Belk Stores*, 799 F.2d at 908, concluded that where a supplier terminates a discounter in response to an ultimatum from a better dealer, there is no agreement at all within the meaning of *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919). In such circumstances, the supplier is not "agreeing" to do anything. It is simply sacrificing one customer in order to retain a better customer. Such an action is in the independent self-interest of the supplier. Consistent with *Monsanto*, it fails to give rise to any section 1 claim. *Belk Stores*, 799 F.2d at 911. *See also Oreck Corp.* v. *Whirlpool Corp.*, 579 F.2d 126, 131 n.6 (2d Cir.) (ultimatum cases should be evaluated under the rule of reason), *cert. denied*, 439 U.S. 946 (1978).

further highlights the improvidence of the new *per se* rule that BEC advocates.

The reason any supplier adopts a system of restricted distribution—be it a territorial restraint, an exclusive dealership, or some other formulation—is to reduce intrabrand price competition so that its dealers can focus on competing against other suppliers' brands:

> The adoption of a restricted distribution system implies a decision to emphasize nonprice competition over price competition, which such a system tends to suppress.

Valley Liquors, Inc. v. *Renfield Importers, Ltd.*, 678 F.2d 742, 743-44 (7th Cir. 1982).

To ask a jury whether the supplier's motive in refusing to deal with a particular customer was a desire to reduce price competition or a desire to promote a system that has the necessary effect of reducing price competition, and to have *per se* illegality hinge upon this semantic distinction, is a tenuous basis for a rational system of antitrust jurisprudence in any context. In the free rider context, permitting a jury to attempt to draw such a distinction makes even less sense. By definition, a free rider competes on the basis of the discount prices its lower sales costs enable it to charge. While not all discounters are free riders, all free riders are discounters. *Beach* v. *Viking Sewing Machine Co.*, 784 F.2d 746, 751 n.6 (6th Cir. 1986); *see generally* Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 12-13 (1981). When a full service dealer complains about a free rider, it is complaining about the free rider's discounting. *See, e.g.*, *Isaksen* v. *Vermont Castings, Inc.*, 825 F.2d 1158, 1161-62 (7th Cir. 1987); *National Marine Electronic Distributors, Inc.* v. *Raytheon Co.*, 778 F.2d 190, 191 (4th Cir. 1985). Concomitantly, when a supplier agrees to terminate a free rider to stop its free riding, a supplier is agreeing to terminate a discounter to stop its discount price competition.

The policies of *Sylvania* and *Monsanto* would be frustrated by a rule that permits the jury to speculate as to whether a supplier

terminated a free rider because of free riding or because of discounting. Rather than risk treble damage liability because of the possibility that a jury might conclude that its efforts to deter free riding and promote an efficient distribution system were motivated by an antipathy toward intrabrand price competition, a supplier would simply forego requiring the kind of promotional and educational services that benefit the marketplace as a whole.

This is not an academic concern. The marketplace does not run by itself. Each day a supplier must make a myriad of decisions regarding marketing practices generally and its distribution system specifically. No matter how attractive the Sharp product, if Sharp does not have an effective distribution system that product will sit on the warehouse floor. An inefficient distribution system benefits no one, and once a supplier realizes a particular dealer is inappropriate, undue delay in correcting the situation is costly.

Many suppliers have literally thousands of dealers or distributors throughout the United States and each day face questions of whom to appoint, whom to terminate and when to terminate in order to build a more efficient, competitive distribution system. Suppliers cannot do this if the antitrust laws treat every dealer termination as a near occasion to treble damage liability, or force them to guess at their peril as to how a jury, unchecked by any objective criteria, will perceive their motives in making these changes.

To ensure that the antitrust laws do not have the anomalous effect of chilling the very conduct authorized by *Sylvania*, the objective rule prescribed by *Monsanto*—whatever the motivation for the termination, did the supplier and the remaining dealer actually agree to fix prices—is far preferable. As Judge Posner recently stated for the court in *Morrison* v. *Murray Biscuit Co.*, 797 F.2d 1430, 1440 (7th Cir. 1986), citing with approval the decision of the court of appeals in this case: "[A]ntitrust liability should not turn on a court's guess as to which motive may have predominated."

Finally, although BEC speaks in terms of motives, it also appears that BEC is suggesting that promotional, educational or other dealer services were not necessary in this case, and that Sharp's actions had an adverse effect on competition. *See, e.g.*, BEC Br. at 31. If this is BEC's argument, it suffices to say that BEC is simply wrong. The record affirmatively establishes that Sharp's conduct was both reasonable and pro-competitive.

In 1973 the electronic calculator industry involved a new product that was complex and expensive. This structure necessitated promotion, education and other dealer level services if demand was to be stimulated. Tr. 113-14; 343-48; 1429-32. This structure also invited free riding, *see generally Isaksen* v. *Vermont Castings, Inc.*, 825 F.2d 1158, 1161-62 (7th Cir. 1987), and the record makes clear that BEC was in fact free riding on Hartwell's sales efforts. Tr. 110; 279-80; 283-84; 343-44; 346-48; Pet. App. at 20a (Jones, J., concurring).

The record also shows that, consistent with the *Sylvania/Monsanto* model, Sharp's actions were not injurious to competition:

> Only atavistic devotees of the abacus or slide rule could fail to recall the remarkable history of the electronic calculator market during the last fifteen years. The range of available models, variety of functions that can be performed, and myriad optional enhancements have multiplied rapidly while the average prices have plummeted. The number of competing manufacturers has increased. To maintain their market position and profitability, manufacturers like Sharp have obviously been required to react quickly and imaginatively to changes in the marketplace. The record in this case reveals that both Sharp's market share and the retail prices of its calculators were declining in this period.

Pet. App. at 19a-20a (Jones, J., concurring) (footnote omitted).

Thus, whether considered in terms of broad generalities or on the specific facts of this case, there is no basis to assume that where a supplier agrees to terminate a discounting dealer, it has an anticompetitive purpose, nor any reason to believe that the

effect of the termination—even if it results in a higher price at the dealer level—is without redeeming competitive value. Accordingly, the conclusion of the court of appeals that an agreement to terminate a discounting dealer—absent evidence of actual price fixing—should not be subject to condemnation by a *per se* rule should be affirmed.

POINT III
ALL VERTICAL RESTRAINTS SHOULD BE EVALUATED UNDER THE RULE OF REASON

The same reasons leading to the conclusion that vertical non-price restraints are subject to the rule of reason support the conclusion that vertical price restraints should also be subject to the rule of reason.

BEC maintains that the issue of how to treat vertical price fixing is not before the Court. BEC Br. at 36 n.11. However, while Sharp's cross-petition—which asked the Court to hold vertical price fixing subject to the rule of reason and to order dismissal of the case—is still pending, much of BEC's brief, and the briefs of its *amici*, are devoted to the proposition that the rule holding resale price maintenance *per se* illegal should not be disturbed. Their arguments deserve a brief response.[21]

A. There Is No Economic Justification For The Application Of The *Per Se* Rule To Vertical Price Restraints

The *per se* rule applicable to resale price maintenance has not been re-examined by this Court since it was adopted some 75

21. Even if BEC had not injected this issue into the case, it still would be properly before the Court since a determination that resale price maintenance is subject to the rule of reason constitutes an alternative basis for affirmance. The judgment below was a reversal and remand for a new trial. A determination that the *per se* rule no longer applies may well permit BEC to re-try the case on a rule of reason theory in light of the change in law. *Cf. Sylvania*. Accordingly, a finding that resale price maintenance is no longer subject to the *per se* rule would not alter or enlarge the relief granted below and thus may be heard at this time. *Blum v. Bacon*, 457 U.S. 132, 137 n.5 (1982); *see generally* R. STERN, E. GRESSMAN & S. SHAPIRO, SUPREME COURT PRACTICE § 6.35, at 382 (6th ed. 1986).

years ago in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911). Consistent with the traditional analysis applied by this Court, the *per se* rule can be justified only if there is some basis for concluding that resale price maintenance is in fact inimical to the goals of the Sherman Act. *Sylvania*, 433 U.S. at 49-50, 50 n.16, 52-53.

The holding in *Sylvania* that vertical non-price restraints are subject to the rule of reason calls into question the continued vitality of applying the *per se* rule to vertical price restraints. *Sylvania*, 433 U.S. at 70 (White, J., concurring). Accordingly, in *Monsanto* the United States asked the Court to review this issue precisely because:

> Such an analysis would show that resale price maintenance, like the nonprice vertical restrictions in *Sylvania*, can have significant procompetitive effects.

Brief for the United States as Amicus Curiae in Support of Petitioner on Writ of Certiorari at 21, *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984) (hereinafter cited as "U.S. Br. in *Monsanto*").[22]

Leading commentators also have emphasized that the *per se* prohibition on resale price maintenance has little legitimacy in light of the principles set forth in *Sylvania*. *E.g.*, Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 9 (1981) ("[A]ny free-rider or other arguments that are available to justify exclusive territories are equally available to justify resale price maintenance."); *accord* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 171 (1984); Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way Out?*, 67 VA. L. REV. 1457, 1465-67 (1981); Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171, 181-82. This view has

22. The Court did not reach the issue in *Monsanto* because it was not raised by the parties below. 465 U.S. at 761 n.7. Here, there is no dispute that Sharp properly preserved this issue. *See* Tr. 1584-87; 1594-95; 1598-99; Defendant's Requested Jury Instruction Nos. 23 and 26.

recently been echoed in judicial opinions as well. *E.g.*, *Isaksen* v. *Vermont Castings, Inc.*, 825 F. 2d 1158, 1161-62 (7th Cir. 1987); Pet. App. at 22a-23a (Jones, J., concurring).

While vertical price restraints can be used to achieve all the competitive advantages that vertical non-price restraints achieve—the securing of efficient dealers, providing the impetus to those dealers to furnish pre-sale, point-of-sale or post-sale promotional and educational services and deterring free riding—they present no greater competitive threat than do non-price restraints.

A supplier is unlikely to use a vertical price fixing agreement merely as a way to raise resale prices. If for some reason that were a supplier's goal, it could achieve that goal by any number of infinitely simpler, safer and more effective means. The supplier could raise its price to the dealers so that the dealers would have to raise their resale prices to realize a profit; the supplier could transfer to its dealers on a bona fide consignment basis and legally control their resale prices; or the supplier could do away with a dealership network altogether, vertically integrate, and sell to end users directly via employees or indirectly via independent sales agents, charging whatever price the supplier wants. None of these activities would implicate, much less violate, section 1 of the Sherman Act. *Ryko Manufacturing Co.* v. *Eden Services*, 823 F. 2d 1215, 1222-23 (8th Cir. 1987); *see generally* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. at 143-48.

The supposition that given the power to fix resale prices a supplier would set an excessively high price is an economic makeweight. The supplier's price to the dealer is not affected by the dealer's resale price. Any excessive profit realized from the resale goes into the dealer's pocket. The only rational motivation for a supplier is to fix resale prices at the lowest level necessary to ensure that the dealer can provide necessary promotional and other customer services. As Judge Posner explained in *Isaksen*, 825 F.2d at 1161:

> If the floor were set higher than necessary to induce dealers to provide the point-of-sale services that would maximize the sales of [the manufacturer's] stoves, [the manufacturer] not only would be transferring wealth from itself to its dealers (and why would it want to do that?) but would be pricing its stoves out of the market. . . .

Therefore, rather than endeavoring to effect an economically senseless price gouge, a manufacturer who employs resale price maintenance usually will be attempting to provide an incentive to its dealers to handle its product in a way that the manufacturer expects will be advantageous in interbrand competition. In other words, it will be using a vertical restraint to increase the sales of its product at the expense of competing suppliers. That is not a pernicious end. It is exactly what suppliers should be doing in a competitive market. There is no need for the antitrust laws to discourage such conduct, and every reason for these laws to encourage it. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 89-96 (1960); R. POSNER, ANTITRUST LAW, AN ECONOMIC PERSPECTIVE at 148-49 (1976).

Accordingly, no economic justification exists for continuing the *per se* prohibition on vertical price fixing.

B. There Are Substantial Economic And Practical Justifications For The Application Of The Rule Of Reason To Vertical Price Restraints

The economic and practical justifications for changing the prohibition are many. In numerous circumstances, resale price maintenance can actually promote competition more effectively than non-price restraints. In some cases, it will be the only way to ensure that dealers provide the requisite pre-sale, point-of-sale or post-sale services needed to stimulate demand and benefit the consumer. While BEC's free riding was ameliorable by Sharp's granting Hartwell the equivalent of an exclusive territory, in

other circumstances this would not have solved the problem.[23] Where dealers must be close together geographically, an exclusive territory is no remedy at all. A resale price fixing agreement "may be the only feasible method [of limiting intrabrand competition among dealers] where effective retail distribution requires that dealers be located close to one another. . . ." Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. at 9.

Where, unlike the instant case, a resale price fixing agreement would constitute the only realistic way of preventing free riding, the sole option available under present law is for the supplier to suffer the free riding, however damaging that might be to its distribution network or to the marketplace generally. It is far preferable to permit the supplier to insist on a fixed price high enough to cover the full service dealer's costs.

Taking account of exactly these factors, the United States has held firm to the view that vertical price fixing is not merely a neutral, but frequently a pro-competitive, device. Although appropriation legislation prohibited the United States from supporting Sharp's cross-petition, *see* U.S. Br. at 15, the head of the Antitrust Division of the United States Department of Justice recently testified before Congress that the Government's views expressed in *Monsanto* have not changed:

> The Department of Justice filed a brief as *amicus curiae* in the *Monsanto* case expressing serious doubts as to the continued legitimacy of the current *per se* rule. We invited the Supreme Court to re-examine the rule, urging that resale price maintenance usually will not be used by the manufacturer simply to increase the retail price of its product, since it can do that more directly by raising its wholesale price. Rather, resale price maintenance usually will be designed to promote interbrand competition by

23. In fact, the free rider effect, which was a principal reason relied on by the *Sylvania* Court for treating restricted distribution under the rule of reason, was originally presented as a justification for vertical price fixing agreements, not as a justification for territorial or other non-price vertical restraints. *See* Telser, *Why Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

> encouraging dealers, *inter alia*, to train sellers, to undertake effective sales promotions, to create attractive showrooms, and to support informational, maintenance or repair services. Resale price maintenance curtails "free rider" dealers, who sell at discount prices to customers attracted to a product by other dealers' advertising or other promotional activities and who thus thwart procompetitive efforts desired by the manufacturer. Economists have posited several other procompetitive explanations of resale price maintenance as well.
>
> . . . .
>
> For the reasons articulated in our *Monsanto* brief, we view resale price maintenance agreements as potentially procompetitive—not just competitively neutral—in many circumstances.

Statement of Charles F. Rule, Acting Assistant Attorney General, Before the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Judiciary Committee at 6-7 (Apr. 23, 1987); *see also* Address of D. Oliver to the Antitrust Law Section of the American Bar Association (Aug. 12, 1986), *reprinted in* 5 Trade Reg. Rep. (CCH) ¶ 50,481, at 56,287-88.[24]

C. There Is No Congressional Impediment To This Court's Application Of The Rule Of Reason To Vertical Price Restraints

BEC points out that there has been much legislation in the section 1 area and contends that Congress has, by implication, codified the *per se* rule against vertical price fixing. BEC also suggests that Congress is better equipped than the Court to determine what is and is not *per se* illegal in the vertical context. BEC Br. at 36-38, 38 n.12, 40 n.14, 41-42.

The short answer to BEC's argument that Congress, not the Court, is the appropriate arbiter of *per se* rules is that this argument was made—and soundly rejected—in *Sylvania*. There, this Court reaffirmed that the evaluation of the *per se* rule, particularly in the context of vertical restraints, is the proper office of the judiciary. *Sylvania*, 433 U.S. at 57 n.27.

With respect to its companion argument that Congress has in fact spoken by implication on this point, BEC ignores one rather salient fact. BEC fails to mention that, in the wake of *Monsanto*, legislation was proposed that would explicitly codify the *per se* rule in this context. S. 430, 100th Cong., 1st Sess., 133 Cong. Rec. 1484 (1987); H.R. 585, 100th Cong., 1st Sess. (1987). However, Congress has never enacted that legislation.[25]

In sum, it is well-settled with respect to the Sherman Act that Congress intended the courts to "give shape to the statute's broad mandate by drawing on common-law tradition." *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 688 (1978); *accord Associated General Contractors, Inc.* v. *California State Council of Carpenters*, 459 U.S. 519, 530-32 (1983). This Court has a special responsibility to revisit and reconsider the application of the Sherman Act as circumstances warrant. This is not an ordinary case of statutory construction where deference to the legislature (and legislative inactivity) is warranted. The Sherman Act is basically a court-made rule, and therefore can and should be changed by the courts—in particular this Court—when it proves unwise or economically counterproductive as in this case. BEC presents no basis whatsoever for this Court to retreat from its traditional role of determining when and to what extent the *per se* rule should be applied. *See Sylvania*, 433

24. Undoubtedly, in some circumstances vertical price restraints would not be pro-competitive. If it could be shown that such restraints were being used to foster a supplier or dealer level cartel, that practice would likely fall within categories of *per se* condemnation applicable to horizontal arrangements. Even if the horizontal element went undetected, such practices would still be subject to condemnation under a rule of reason analysis. But to perpetuate a *per se* rule that time has taught to be counterproductive on the ground that circumstances could be hypothesized in which a finding of illegality would make sense violates the basic tenets underlying the *per se* rule. *See* U.S. Br. in *Monsanto* at 7.

25. The repeal of the fair trade laws, relied upon by BEC as "evidence" of Congressional intent in this regard, BEC Br. at 40 n.14, and other issues of legislative history germane to BEC's argument, were addressed at length by the United States in *Monsanto*. *See* U.S. Br. in *Monsanto* at 27-28.

U.S. at 57 n.27; *United States* v. *Associated Press*, 52 F. Supp. 362, 370 (S.D.N.Y. 1943), *aff'd*, 326 U.S. 1 (1945).

D. This Case Perfectly Illustrates Why Vertical Price Restraints Should Be Evaluated Under The Rule Of Reason

Not only is there good reason for the Court to review and revise the *per se* rule applicable to vertical price restraints, but there is good reason to do so now. As this Court stated in *Sylvania*, 433 U.S. at 51-52, 57-59, too broad an application of the *per se* rule in the vertical context is dangerous because it deters practices that are actually beneficial to competition. The *per se* rule against vertical price fixing should not be continued simply on the basis that it has been in place for a long time, particularly where experience teaches that the rule is harmful to the marketplace as a whole.

And harmful that rule is. This Court has recognized that vertical price restraints are frequently indistinguishable—both in form and effect—from non-price restraints. *Monsanto*, 465 U.S. at 762. Continuing to treat vertical price restraints as *per se* illegal, while acknowledging that in form and effect they are generally indistinguishable from other, presumptively legal, vertical restraints is not only anomalous, *see* Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. at 171, and not only ensures an ever swelling volume of lawsuits by terminated dealers, *see* Pet. App. at 21a-22a,[26] but also presents the precise danger of interdicting pro-competitive conduct warned of in *Monsanto*. 465 U.S. at 764.

26. Judge Jones, concurring below, expressed with admirable clarity the reality of this problem:

> Most clever attorneys, like plaintiff's counsel in this case, will be able to generate sufficient evidence, even pursuant to the *Monsanto* standard, to withstand summary judgment review, and thus to exert substantial influence toward settlement of cases where no anticompetitive harm, or harm to the consuming public, really occurred.

Pet. App. at 21a-22a.

As post-*Monsanto* decisional law establishes, efforts to alleviate the anticompetitive effects of the *per se* rule in the vertical context by strengthening the standards of proof or tightening the definition of price fixing are unavailing. Terminated dealers will continue to challenge terminations as products of price fixing agreements, and the monumental costs and burdens of such suits will necessarily deter suppliers from adopting distribution methods that could otherwise be beneficial both to themselves and to interbrand competition. *See* Pet. App. at 21a-22a (Jones, J. concurring).

This is well illustrated by the instant case. While the court of appeals adopted a carefully focused definition of vertical price fixing, it did not dismiss the complaint against Sharp. Rather, it remanded the case for a new trial on the basis that Hartwell's general adherence to Sharp's suggested resale prices permitted an inference of a price fixing agreement, even though Hartwell testified that his pricing was always the product of independent judgment and not the product of coercion by Sharp. Tr. 294; 327; 332; 333.[27] However, the natural effect of any intrabrand vertical restraint is to impose costs upon a dealer that will necessitate its raising resale prices. In any vertical restraint case, therefore, the predicate for finding an agreement that somehow affects price will exist, even under the court of appeals' standard.

The record in this case shows that interbrand competition in the electronic calculator market was not only fierce at the time of the events in question, but actually *increased* subsequent to the termination of BEC, and has resulted in a reduction in prices and an improvement in the quality and number of products available.

27. It should be noted that the standard for a permissible inference of price fixing enunciated by the court of appeals falls far short of the *Monsanto* standard. In *Monsanto*, 465 U.S. at 764 n.9, the Court made clear that a price fixing agreement cannot be inferred merely from the dealer's adherence to the supplier's suggested price, but also requires evidence that the dealer communicated its acquiescence to the supplier and that this was sought by the supplier.

Tr. 893-94; 931; 1024; 1027-28. For that reason, Judge Jones stated below:

> I believe this case perfectly illustrates the arguments why vertical price restraints should be tested under antitrust's Rule of Reason rather than, as *Monsanto* continues to require, per se illegality. There is no social benefit to subjecting manufacturers' pricing relationships with their distributors to potential per se illegality where they operate in markets whose interbrand competitiveness overwhelms any detrimental effects of those relationships. And, although *Monsanto* moves toward alleviating the threat of unwarranted treble-damage actions, the abiding uncertainty suggests that the Supreme Court would more wisely jettison the precedent that led to the rule of per se illegality for vertical price restraints.

Pet. App. at 19a (footnote omitted).

This Court admonished in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 1356 (1986), that the range of permissible inferences under the antitrust laws is limited, and that permitting illogical inferences to be drawn from proven facts could deter the kind of competitive behavior the antitrust laws are designed to promote. It is illogical, if not irrational, to presume conclusively that vertical price fixing is *per se* injurious to competition where conduct indistinguishable in economic effect is regularly regarded as affirmatively pro-competitive. The rule that compels such a presumption should be rejected by this Court.

CONCLUSION

For the foregoing reasons, Respondent Sharp Electronics Corporation respectfully requests that this Court affirm the judgment of the court of appeals.

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Respectfully submitted,

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