ANTITRUST—PRICE FIXING—VERTICAL NON-PRICE RESTRAINT OF TRADE NOT ILLEGAL PER SE UNDER SHERMAN ACT—*Business Electronics Corp. v. Sharp Electronics Corp.*, 108 S. Ct. 1515 (1988).

Contracts restraining trade have been actionable from early common law.[1] Congress, by enacting the Sherman Act in 1890, extended federal jurisdiction over restraint of trade in interstate commerce.[2] The Sherman Act's broad scope brought the full weight of the common law to bear on situations involving restraint of trade.[3]

The anti-social impact of horizontal[4] restraint of trade agreements has long been an accepted fact.[5] The application of antitrust law to vertical restraint,[6] however, continues to undergo review and modification. The most recent holding by the United States Supreme Court in this narrow arena, *Business Electronics Corp. v. Sharp Electronics Corp.*,[7] requires the application of the rule of reason[8] to vertical non-price combinations resulting in the re-

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1 United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

> First. The mischief which may arise from them (1) to the party by the loss of his livelihood and the subsistence of his family; (2) to the public by depriving it of an [sic] useful member. Another reason is the great abuses these voluntary restraints are liable to; as, for instance, from corporations who are perpetually laboring for exclusive advantages in trade, and to reduce it into as few hands as possible.

Id. at 279 (quoting Mitchel v. Reynolds, 1 P. Wms. 181, 190 (1711)).

2 15 U.S.C. § 1 (1988) provides in pertinent part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

This authority is granted to Congress pursuant to U.S. CONST. art. I, sec. 8, cl. 3.

3 *See* Standard Oil Co. v. United States, 221 U.S. 1, 50-60 (1911).

4 *See* Hay, *Vertical Restraints After Monsanto*, 70 CORNELL L. REV. 418 n.2 (1985). Horizontal restraints are imposed across a level of distribution (between distributors or between retailers, *i.e.*, among competitors) while vertical restraints are between different levels of distribution such as a manufacturer and distributor or retailer. Horizontal restraints may be characterized as being cross-industry, thereby restraining interbrand competition, while vertical restraints are within one chain of distribution and tend to restrain intrabrand competition. *See generally* Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981).

5 *Mitchell*, 1 P. Wms. at 183. "A grant [of a charter] to particular persons for the sole exercise of any known trade . . . is void, because it is a monopoly, and against the policy of the common law, and contrary to *Magna Charta*." *Id.*

6 *See supra* note 4.

7 108 S. Ct. 1515 (1988).

8 *See infra* note 23.

straint of trade.

In 1968, Business Electronics Corporation (BEC) was the sole electronic calculator dealer for Sharp Electronics Corporation (Sharp) in the Houston, Texas area.[9] After several years, Sharp permitted a second dealer, Hartwell, to commence operations as an additional retailer of Sharp products in the Houston market.[10] Approximately one year later, Hartwell complained to Sharp concerning BEC's continuing discount sales strategy.[11] Hartwell delivered an ultimatum regarding BEC to Sharp concerning BEC's sales strategy.[12] Subsequently, Sharp terminated BEC as a dealer in Sharp electronic calculators.[13]

BEC brought an action in the United States District Court for the Southern District of Texas, alleging Sherman Act violations by Sharp.[14] A jury entered judgment in favor of BEC.[15] On appeal, the Fifth Circuit Court of Appeals reversed and remanded on the basis of error in the lower court's jury instruction.[16] In remanding, the Fifth Circuit held that there must be an agreement to set prices in order for there to be a per se violation.[17] Moreover, an agreement to terminate a price cutting competitor may violate the Sherman Act, but must be evaluated

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9 Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212, 1214-15 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988).

10 *Sharp*, 108 S. Ct. at 1517.

11 *Id.* at 1518. Sharp provided its retailers with lists suggesting retail prices. *Id.* Sharp's agreements with its retailers, however, did not require them either to observe such prices nor suggested any other price. *Id.* BEC's prices were regularly below Sharp's suggested retail prices as well as Hartwell's prices. *Id.* Hartwell's primary contention, however, was that BEC was " 'free riding' on Hartwell's provision of presale educational and promotional services by providing inadequate services." *Id.* "Free riding" is a term used to indicate a discounter who takes advantage of the service or advertising investment of a full price interbrand competitor serving the same market. *Sharp*, 780 F.2d at 1221 n.3 (Jones, J., concurring).

12 *Sharp*, 108 S. Ct. at 1518.

13 *Id.*

14 *See Sharp*, 780 F.2d at 1214.

15 *Id.*

16 *See id.* at 1219-20. The district court had instructed the jury that "an agreement between Sharp and Hartwell to terminate BEC because of the latter's price cutting constitute[d] a *per se* violation of section 1 of the Sherman Act." *Id.* at 1215. The specific instruction to the jury was:

> 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. Plaintiff contends that Sharp terminated Business Electronics in furtherance of Hartwell's desire to eliminate Business Electronics as a price cutting rival.

Id.

17 *Id.* at 1218.

under the rule of reason standard.[18]

The Supreme Court granted certiorari[19] and affirmed the Fifth Circuit's decision.[20] The Court held that absent "some agreement on price or price levels," non-price vertical agreements are not per se violations of section 1 of the Sherman Act.[21]

The law on vertical agreements in restraint of trade has seen considerable development over the life of the Sherman Act.[22] Ordinarily a reviewing court determines whether a particular agreement violates section 1 of the Sherman Act by utilizing the rule of reason.[23] There are, however, instances where courts have held vertical agreements to be per se illegal.[24]

The United States Supreme Court's 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[25] initially deemed resale price maintenance to be illegal per se. In *Dr. Miles*, the Court invalidated price fixing agreements between a manufacturer and its wholesalers and retailers.[26] The Court reasoned that, after receiving reasonable compensation for its product, a manufacturer possessed no further interest in the product and that "the public is entitled to whatever advantage may be derived from competition in the subsequent traffic."[27]

In a dissenting opinion, Justice Holmes recognized the difference between agreements designed to close a given market to outside parties and those that tend to control the destiny of one's own product.[28] The Justice reasoned that a manufacturer's sales

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18 *Id.* at 1216.

19 Business Electronics Corp. v. Sharp Electronics Corp., 482 U.S. 3182 (1987).

20 *Sharp*, 108 S. Ct. 1515, 1525 (1988).

21 *Id.*

22 *Id.* at 1519. *See, e.g.*, Continental T.V. Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) (vertical non-price restraints pertaining to exclusive territories are not per se illegal); Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1957) (vertical restraints not price related are not per se illegal); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911) (vertical agreements concerning resale prices are per se illegal).

23 *Sharp*, 108 S. Ct. at 1519. In applying the rule of reason, "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." *Id.* (quoting Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 49 (1977)). *Id.*

24 *Id.* *See* Northwest Wholesale Stationers, Inc. v. Pacific Stationary & Printing Co., 472 U.S. 284, 289-90 (1985), wherein the court stated that certain conduct "would always or almost always tend to restrict competition and decrease output." *Id.*

25 220 U.S. 373 (1911).

26 *Id.* at 409.

27 *Id.*

28 *Id.* at 410-13 (Holmes, J., dissenting).

I see nothing to warrant my assuming that the public will not be served activities should be judged in light of their purpose.[29] This recognition foreshadowed a continuing source of conflict for the Court in later decisions between the application of per se versus rule of reason analysis.[30]

In *United States v. Colgate & Co.*,[31] the Court first confronted a scenario involving a unilateral action by a manufacturer.[32] Colgate, through distribution of circulars and price lists, established the prices at which it wished its products be sold.[33] It was further explained to the dealers that deviation from those prices would result in the termination of Colgate's relationship with that dealer.[34] Upholding Colgate's right to determine with whom it will contract,[35] the Court stressed that a party may predetermine and announce the basis on which it will refuse to sell.[36] The Court reasoned that the fact Colgate allowed the retailer to set prices as it saw fit avoided the problem raised in *Dr. Miles*, even though the retailer in *Colgate* was effectively in the same position.[37] Therefore, the unilateral nature of the conduct by Colgate distinguished the *Colgate* decision from the Court's earlier *Dr. Miles* decision.[38]

Twenty-five years later, in *United States v. Bausch & Lomb Optical Co.*,[39] the Court reaffirmed the position it espoused in *Colgate*. The *Bausch & Lomb* Court considered an arrangement in which

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> best by the company being allowed to carry out its plan. I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.

Id. at 412 (Holmes, J., dissenting).

29 *Id.*

30 *See, e.g.*, National Soc. of Prof. Eng'rs v. United States, 435 U.S. 679 (1978) (horizontal agreement prohibiting competitive bidding constitutes price fixing and is illegal per se); Continental T.V., Inc. v. G.T.E. Sylvania, Inc., 433 U.S. 36 (1977) (rule of reason applied to exclusive territory agreement); United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967) (per se rule used in non-price vertical restraints); United States v. Socony-Vacuum Oil Co., Inc., 310 U.S. 150 (1940) (per se rule applied to horizontal price fixing).

31 250 U.S. 300 (1919).

32 *Id.*

33 *Id.* at 302-03.

34 *Id.* at 305-06.

35 *Id.* at 307. "The retailer, after buying, could, if he chose, give away his purchase, or sell it at any price he saw fit, or not sell it at all. . . . [B]y his action [he may] incur the displeasure of the manufacturer, who could refuse to make further sales to him. . . ." *Id.* at 306.

36 *Id.* at 306-07.

37 *Id.* at 307-08.

38 *Id.*

39 321 U.S. 707 (1944).

Soft-Lite, a distributor of tinted eyeglass lenses, established its wholesale and retail network through licensing agreements.[40] Soft-Lite sold only to licensed wholesalers who, in turn, were only permitted to sell to licensed retailers.[41] This methodology of controlling the distribution network, the Court found, exceeded the unilateral conduct validated in *Colgate*.[42] The Court determined that Soft-Lite's actions constituted "a conspiracy to maintain prices down the distribution system,"[43] and therefore held Soft-Lite's actions to be illegal per se under section 1 of the Sherman Act.[44]

The Court's position in *Bausch & Lomb* was confirmed in *United States v. Parke, Davis & Co.*,[45] wherein the Court concluded that the defendant's actions exceeded the scope of the *Colgate* doctrine which protected a distributor's right to refuse to do business with a party.[46] In this case Parke, Davis was found to have violated the Sherman Act by actively threatening to not fill dealers' future orders as a method of ensuring that they comply with its suggested retail prices.[47] The Court held that this vertical arrangement was illegal per se.[48]

Three years later, in *White Motor Co. v. United States*,[49] the Court addressed the question of whether contracts which restricted the geographical boundaries of retailers' activities represented a per se violation of the Sherman Act.[50] The *White Motor* Court held that horizontal territorial agreements are per se violations, and that such agreements "are naked restraints of trade with no purpose except [the] stifling of competition."[51] How-

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40 *Id.* at 709-10.

41 *Id.* at 710.

42 *Id.* at 729.

43 *Id.* at 720.

44 *Id.* at 729.

45 362 U.S. 29 (1960).

46 *Id.* at 43. The Court stated:

> [A]n unlawful combination is not just such as arises from a price maintenance *agreement*, express or implied; such a combination is also organized if the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy.

Id. (emphasis in original).

47 *Id.* at 33.

48 *Id.* at 47.

49 372 U.S. 253 (1963).

50 *Id.* The district court held that geographical restrictions placed on distributors and retailers were per se violations and therefore exercised its power of summary judgment. *Id.* at 256.

51 *Id.* at 263.

ever, the territorial arrangements in *White Motor* were vertical in nature and thus were subject to rule of reason analysis.[52]

Shortly after *White Motor*, the case of *United States v. General Motors Corp.*[53] presented the Court with a more onerous example of a vertical combination. In *General Motors*, several automobile dealer associations in the Los Angeles area banded together to force General Motors to eliminate the discount auto sales in the region.[54] The Court avoided dealing with the territorial restraint issue, and instead focused on whether a combination or conspiracy existed.[55] The Court found "a classic conspiracy in restraint of trade" in the dealer association's action with General Motors to eliminate the discount auto trade and analogized the boycott to a horizontal agreement.[56] The Court accordingly ruled the boycott's "pernicious effect on competition" to be a per se violation of section 1 of the Sherman Act.[57]

The Court broadened the applicability of the per se rule in *United States v. Arnold, Schwinn & Co.*[58] In *Schwinn*, the Court grappled with dealer territorial and resale restrictions, rather than price fixing, imposed by the manufacturer.[59] Schwinn sold to dis-

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52 *Id.* at 264.

53 384 U.S. 127 (1966).

54 *Id.* at 133-38. The dealers contended that the discounters, often including dealers acting in concert with the discounters, violated the "location clause" in the dealer selling agreement. *Id.* at 139. The agreement prohibited "a franchised dealer from moving to or establishing 'a new or different location, branch sales officer, branch service station, or place of business . . . without the prior written approval of Chevrolet.' " *Id.*

55 *Id.* at 139-41. "[B]ecause the action taken constitutes a combination or conspiracy, it is not necessary to consider what might be the legitimate interest of a dealer in securing compliance by others with the 'location clause,' or the lawfulness of action a dealer might individually take to vindicate this interest." *Id.* at 140.

56 *Id.* The Court found a "joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose." *Id.*

57 *Id.* at 146 (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1957)). "There can be no doubt that the effect of the combination or conspiracy here was to restrain trade and commerce within the meaning of the Sherman Act. Elimination, by joint collaborative action, of discounters from access to the market is a *per se* violation of the Act." *Id.* at 145.

58 388 U.S. 365 (1967).

59 *Id.* at 372-73. The Court found *Schwinn* to involve:

> a truly vertical arrangement, raising the fundamental question of the degree to which a manufacturer may not only select the customers to whom he will sell, but also allocate territories for resale and confine access to his product to selected, or franchised, retailers. We conclude that the proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer

tributors directly (thereby surrendering title to the goods) and through a consignment scheme whereby Schwinn retained title to the goods.[60] The *Schwinn* Court departed from the standard enumerated in *White Motor*, holding that agreements pertaining to restraints on the resale of goods were per se violations.[61] However, restraints over goods to which Schwinn retained title, in the Court's view, were instead subject to rule of reason analysis.[62]

The bifurcated standards of review established in *Schwinn* proved to be short lived. In *Continental T.V., Inc. v. GTE Sylvania Inc.*,[63] the Court reviewed and overturned the *Schwinn* doctrine regarding restraints in a vertical distribution system.[64] Continental alleged that Sylvania, by its franchise agreement allowing Continental to sell Sylvania's products only at specific locations, violated section 1 of the Sherman Act.[65] The Court held that per se illegality applied only where the vertical restraints questioned were "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."[66] Further, the Court stated that the *Schwinn* Court's distinction "between sale and non-sale transactions" was not sufficient to sustain the bifurcated standards of review established in *Schwinn*.[67] Therefore, the *Sylvania* Court concluded that the rule of reason standard

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> parts with title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss.

Id. at 378-79.

60 *Id.* at 379-80.

61 *Id.* at 382. The Court reasoned that:

> When we look to the product market as a whole, we cannot conclude that Schwinn's franchise system with respect to products as to which it retains ownership and risk constitutes an unreasonable restraint of trade. This does not, of course, excuse or condone the *per se* violations which, in substance, consist of the control over the resale of Schwinn's products after Schwinn has parted with ownership thereof.

Id.

62 *Id.* at 380-81. The Court concluded that "the vertically imposed distribution restraints — *absent* price fixing and in the presence of adequate sources of alternative products to meet the needs of the unfranchised—may not be held to be *per se* violations of the Sherman Act." *Id.* at 381 (emphasis in original).

63 433 U.S. 36 (1977).

64 *Id.* at 58.

65 *Id.* at 40.

66 *Id.* at 57 (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

67 *Id.* The *Sylvania* Court concluded "that the distinction drawn in *Schwinn* between sale and nonsale transactions is not sufficient to justify the application of a per se rule in one situation and a rule of reason in the other." *Id.*

should be used to evaluate all non-price vertical restrictions.[68]

The logic developed in *Sylvania* was subsequently applied by the Court in a distributor termination case. In *Monsanto Co. v. Spray-Rite Service Corp.*,[69] the Court confronted the question of whether the termination of a price cutting distributor was illegal per se under section 1 of the Act.[70] Spray-Rite alleged that Monsanto and several of its other distributors conspired to set Monsanto's resale prices, and that Spray-Rite's distributorship was terminated because of Spray-Rite's failure to abide by those prices.[71] The district court had instructed the jury that if Monsanto conspired with other distributors with the intent to fix prices, as inferred by other distributors' complaints, the action constituted a per se violation.[72] While affirming the lower court's findings that Monsanto conspired with others to fix prices, the Court held that such findings should have been based upon evidence concerning whether the parties "had a conscious commitment to a common scheme designed to achieve an unlawful objective," rather than based upon other distributors' complaints.[73] The Court, however, concluded that the jury had been supplied sufficient evidence to find that Monsanto had agreed with its other distributors to fix prices and that Spray-Rite had been terminated for failure to abide by the agreement.[74]

Within this historical framework the Court was recently presented with another distributor termination question.[75] Specifically, in *Sharp*, the Court was asked to decide whether a vertical restraint is illegal per se where there is no agreement regarding price or price levels.[76]

Writing for the majority, Justice Scalia began his analysis by recognizing that the Sherman Act has always been applied "to prohibit only unreasonable restraints of trade."[77] This had been accomplished in the past through the case by case analysis apply-

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68 *Id.* at 59. Summarizing its holding, the Court posited that "[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under § 1 of the Act." *Id.*

69 465 U.S. 752 (1984).

70 *Id.* at 757.

71 *Id.* at 756-57.

72 *Id.* at 757.

73 *Id.* at 768.

74 *Id.* at 768 n.14.

75 Business Electronics Corp. v. Sharp Electronics Corp., 108 S. Ct. 1515 (1988).

76 *Id.* at 1525.

77 *Id.* at 1519. Justice Kennedy did not take part in the decision. *Id.* at 1525.

ing the rule of reason.[78] Application of the rule of reason consists of attempting to assess the impact of the questioned activity on free competition.[79] The *Sharp* Court, however, determined that certain activities are so patently detrimental to free competition as to be per se illegal.[80] While horizontal resale price agreements have been held to be illegal per se,[81] Justice Scalia recognized that "the scope of *per se* illegality should be narrow in the context of vertical restraints."[82] The Court stated that, for the per se rule to apply to vertical restraints, the anti-competitive effect of such restraints must be economically demonstrable.[83]

The Court noted that the per se rule was not needed to protect intrabrand competition[84] where interbrand competition provides a " 'significant check' on any attempt to exploit intrabrand market power."[85] The Court also determined that if vertical restraints are illegal per se, manufacturers interested in controlling the ultimate marketing of their products would be forced to integrate the product distribution system into their own operations.[86] Such an integration would have the impact of eliminating opportunities to create that distribution system by small businesses.[87] Accordingly, the Court reasoned that this hampering of the development of small business opportunities, a restriction on trade, was diametrically opposed to the objectives of the Sherman Act.[88] For these reasons, the Court concluded that the rule of reason standard enunciated in *GTE Sylvania*

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78 *Id.* at 1519.

79 *Id. See also* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977).

80 *Sharp*, 108 S. Ct. at 1519.

81 *See* FTC v. Indiana Fed. of Dentists, 476 U.S. 447, 458-59 (1986); National Soc. of Prof. Eng'rs v. United States, 435 U.S. 679, 692 (1978); *Sylvania*, 433 U.S. at 50.

82 *Sharp*, 108 S. Ct. at 1519.

83 *Id.* at 1520-21. The Court noted that "in the vertical restraint context 'departure from the rule-of-reason standard must be based on demonstrable economic effect rather than . . . upon formalistic line drawing.' " *Id.* at 1519 (quoting *Sylvania*, 433 U.S. at 58-59). The *Sharp* Court therefore concluded that "vertical nonprice restraints had not been shown to have such a 'pernicious effect on competition' and to be so 'lack[ing] [in] . . . redeeming value' as to justify *per se* illegality." *Id.* at 1519 (quoting Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

84 *Id.* at 1520.

85 *Id.* (quoting *Sylvania*, 433 U.S. at 52). The Court reasoned that "a manufacturer's dominant incentive is to lower resale prices" in an attempt to meet or beat interbrand competition. *Id.* (citation omitted).

86 *Id.*

87 *Id.*

88 *Id.*

should similarly be applied to vertical non-price restrictions.[89]

In applying the above enunciated standards to the case at hand, the Court found that there was no agreement to fix prices involved in Sharp's decision to terminate BEC.[90] The Court reasoned that Sharp's decision, while impacting on price levels, did not subject it to the terse restrictions of the per se rule.[91] An alternate holding, according to Justice Scalia, would force manufacturers to forego legitimate business options concerning vertical restraints because they may imply price fixing.[92] The Court concluded that, given the variety of valid reasons for termination of a distributor which will necessarily impact upon price levels, the application of rule of reason analysis was mandated.[93]

The Court next examined the common law relevant to restraint of trade which has been incorporated into the Sherman Act.[94] The Court acknowledged that the common law definition of restraint of trade was not a "static" concept in 1890 and continues to "evolve[] with new circumstances and new wisdom."[95] In other words, both the line at which per se illegality becomes applicable and the analysis utilized under the rule of reason must be permitted to adjust to developing economic realities.[96]

Justice Scalia next dismissed BEC's contention that the facts presented paralleled a horizontal combination, rather than the

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89 *Id.* at 1520-21. The Court stated that:

> there is a presumption in favor of a rule-of-reason standard; that departure from that standard must be justified by demonstrable economic effect, such as the facilitation of cartelizing, rather than formalistic distinctions; that interbrand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of *GTE Sylvania*.

Id.

90 *Id.* at 1521.

91 *Id.*

92 *Id.* In noting that it would be "extremely difficult for the manufacturer to convince a jury that its motivation was to insure adequate services, since price cutting and some measure of service cutting usually go hand in hand," the *Sharp* Court held that manufacturers would "forego legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties." *Id.*

93 *Id.* at 1521-22.

94 *Id.* at 1523.

95 *Id.* at 1523-24. The Court stated if the term "restraint of trade" was not interpreted as a fluid concept, "not only would the line of *per se* illegality have to be drawn today precisely where it was in 1890, but also case-by-case evaluation of legality (conducted where *per se* rules do not apply) would have to be governed by 19th-century notions of reasonableness." *Id.* at 1524. The Court further stated that it "would make no sense to create out of the single term 'restraint of trade' a chronologically schizoid statute . . . . " *Id.*

96 *Id.*

vertical combinations the Court found controlling.[97] While BEC attempted to compare the case at bar to *Parke, Davis*,[98] the Court distinguished *Sharp* by noting that Parke, Davis exercised direct control over prices among competitors.[99] In conclusion, the majority held that vertical restraints are not illegal per se unless they include an agreement specifically establishing price or price levels.[100]

In a dissenting opinion, Justice Stevens disputed the majority's finding that the issue in *Sharp* involved a vertical non-price agreement.[101] Instead, the Justice viewed the facts as involving an agreement to control prices among retailers, thus creating a per se illegal horizontal agreement.[102] Justice Stevens maintained that the majority erred in several respects by finding the termination of BEC to be valid.[103]

The first issue raised by Justice Stevens centered around the majority's lack of concern for the differentiation between "naked restraints" and "ancillary restraints."[104] Quoting extensively from Judge Taft's opinion in *United States v. Addyston Pipe & Steel Co.*,[105] the dissent noted that the common law concerns regarding prohibition of naked restraints were included in the Sherman Act.[106] After a discussion of the characteristics of this type of restraint, Justice Stevens concluded that the agreement present in this case did, in fact, constitute a naked restraint of trade.[107]

Moreover, Justice Stevens asserted that this case did not involve a vertical non-price agreement because the manufacturer and second distributor implicitly agreed to a new general price level.[108] This agreement was therefore distinguishable from *Colgate* in that Sharp's action was not unilateral, but instead moti-

97 *Id.* at 1524-25.
98 *Id.* at 1525.
99 *Id.*
100 *Id.*
101 *Id.* at 1526 (Stevens, J., dissenting). Justice White joined in the dissent. *Id.*
102 *See id.*
103 *Id.* at 1526-27 (Stevens, J., dissenting).
104 *Id.* at 1526 (Stevens, J., dissenting). An example of an ancillary restraint is a covenant not to compete in conjunction with the sale of a business. *Id.* Conversely, naked restraints are restraints whose only object is the restraint of trade. *Id.* at 1530 (Stevens, J., dissenting) (quoting White Motor Co. v. United States, 372 U.S. 253, 263 (1963)).
105 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).
106 *Sharp*, 108 S. Ct. at 1526-27 (Stevens, J., dissenting).
107 *Id.* at 1526-27, 1529 (Stevens, J., dissenting).
108 *Id.* at 1528 (Stevens, J., dissenting).

vated by the complaints of the second distributor.[109] Although the dissent conceded that the independent, unilateral termination of a distributor by a manufacturer was a legal transaction, Justice Stevens found that the implicit agreement between Sharp and Hartwell to eliminate BEC constituted a "naked restraint[] of trade with no purpose except [the] stifling of competition."[110]

The dissent further noted that in *General Motors*, the Court found a boycott of several automobile dealers against discounters to be a per se violation of the Sherman Act.[111] Justice Stevens found the facts in *Sharp* indistinguishable from those presented in *General Motors*, since the boycott in *General Motors* was analogous to Hartwell's ultimatum to Sharp.[112] Additionally, the dissent criticized the majority's failure to recognize the value of intrabrand competition in advancing interbrand competition.[113] However, Justice Stevens concluded that such a concern would have been adequate to justify the restraints imposed by the manufacturer.[114]

Finally, Justice Stevens took exception to the majority's failure to recognize the safeguard created by the significant burden of proof placed on the terminated dealer.[115] Reaffirming his belief that juries will continue to be able to distinguish between valid and pretextual defenses in anti-trust litigation, Justice Stevens reasoned that the burden of proof set forth in *Monsanto* would protect dealers in subsequent termination proceedings.[116]

The Court's decision in *Sharp* has continued the process of narrowing the per se rule's applicability to vertical agree-

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109 *Id.*

110 *Id.* at 1530 (Stevens, J., dissenting) (quoting White Motor Co. v. United States, 372 U.S. 253, 263 (1963)).

111 *Id.* at 1532 (Stevens, J., dissenting).

112 *Id.*

113 *Id.*

114 *Id.* at 1532-33 (Stevens, J., dissenting).

115 *Id.* at 1534-35 (Stevens, J., dissenting). First, a "terminated dealer must introduce 'evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently.'" *Id.* at 1534 (Stevens, J., dissenting) (quoting Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752, 764 (1984)). "Second, the terminated dealer must prove that the agreement was based on a purpose to terminate it because of its price cutting." *Id.* at 1534-35 (Stevens, J., dissenting). Lastly, "the manufacturer may rebut the evidence tending to prove that the sole purpose of the agreement was to eliminate a price cutter by offering evidence that it entered the agreement for legitimate, nonprice-related reasons." *Id.* at 1535 (Stevens, J., dissenting).

116 *Id.* at 1533-34 (Stevens, J., dissenting).

ments.[117] The *Sharp* majority requires that nonprice vertical restraints be analyzed under the rule of reason standards enumerated in *Sylvania*,[118] based on the evidentiary standards presented in *Monsanto*.[119] By continuing, however, to recognize the applicability of the per se rule to agreements that "include[] some agreement on price or price levels,"[120] the Court falls short of the mark. Instead, rule of reason analysis should be extended to apply to all vertical agreements, whether price driven or not.[121] Such an extension of the rule of reason's applicability would continue to serve the objectives of the Sherman Act while not hampering valid business activities.[122]

Monopoly power has not been limited by recent judicial decisions concerning vertical restraints. By definition, no monopoly can exist where there is active interbrand competition, yet the non-existence of such competition is self-correcting in a free market.[123] If a manufacturer is fortunate enough, either through

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[117] *See, e.g.*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977); Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

[118] *Sylvania*, 433 U.S. at 49. The Court stated the standard for the rule of reason as follows:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Id. at 49 n.15 (quoting Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)).

[119] *Monsanto*, 465 U.S. at 764.

[120] *Sharp*, 108 S. Ct. at 1525.

[121] *See generally* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 377, 473-74 (1966) (supporting the legality of vertical price fixing); Posner, *supra* note 4, at 25 (vertical restraints are legal barring evidence of agreements among dealers or distributors); Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 159-68 (1984) (use of five filters to determine Sherman Act violations—market power, widespread adoption of identical practices, effect on output, long-lived practices, and profits—violations must result in reduction in competition).

[122] *See supra* notes 1-6 and accompanying text.

[123] *See generally* SAMUELSON, ECONOMICS (8th ed. 1970). Free competition exists when a given market is open to new entrants and therefore subject to pressure from competing products, forcing prices to the lowest level consistent with reasonable profit. *Id.* at 39. The Sherman Act was enacted in reaction to real and perceived damage done by monopolistic organizations. *Id.* at 501. The economic damage

patent rights or creative energy, to have gained the advantage of sole possession of a market, he deserves the rewards of that advantage.[124] In fact, patent laws are designed to protect such an advantage.[125] Market forces combined with the legally protected advantage of patent rights, where applicable, will therefore determine the extent and duration of that advantage.[126] Accordingly, no reasonable governmental intervention between the manufacturer and its distributor or retailer will bring others into an otherwise unprofitable market or keep them out of an otherwise profitable market.[127]

Market forces of the free enterprise system will automatically control any evils derived from vertical price fixing agreements without the need for judicial oversight.[128] Yet the *Sharp* Court continued its support of the per se illegality of vertical price fixing agreements.[129] The majority posited that one potentially valid reason for imposing this position is that vertical price fixing agreements facilitate the cartelization of an industry.[130] While this may be true, the cartelization of an industry is ascertainable and controllable without the legal entanglements forced on business by application of the per se rule to vertical price fixing agreements. Further, cartelization of an industry is in itself a horizontal restraint of trade and, as such, has been recognized by the Court as illegal per se.[131]

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done was via those organizations having the economic power to control a given market and extort greater profits from that market than would otherwise be possible, thereby misallocating resources of the economy. *Id.* at 92-93. The foundation of antitrust policy is that free competition will, over time, result in the most efficient and therefore most favorable allocation of resources. *Id.* at 39.

124 F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE, 437-38 (2d ed. 1980). In a new market, the sole producer will reap the benefit of having the only product available and will therefore charge prices that will result in above average profits. *Id.* at 13. As others recognize the profits to be made in that market, new entrants will force prices lower, absent an agreement between the competing sellers. *Id.* *But compare* ARTHUR A. THOMPSON, JR., ECONOMICS OF THE FIRM, THEORY AND PRACTICE 530-31 (2d ed. 1977), wherein the author stated "[s]ome firms have abused the patent laws by aggressively buying up patents, licenses, and copyrights so as to preclude the emergence of competition from rival products." *Id.* at 530.

125 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 401-02 (1911). *See also* SCHERER, *supra* note 124, at 440-43.

126 *See* THOMPSON, *supra* note 124, at 530; SCHERER, *supra* note 124, at 13.

127 *Id.*

128 *See id.*

129 *Sharp*, 108 S. Ct. at 1519.

130 *Id.* at 1521.

131 *See* Bork, *supra* note 121, at 391. *See also* Easterbrook, *supra* note 121, at 140-43.

The Court has expressed its support for the premise that business should be conducted without overbearing legal interference.[132] Unfortunately, perpetuation of the per se rule in the vertical agreement context continues such interference by forcing a manufacturer to ensure that resale price is not agreed upon with its distributors in its distribution agreements.[133] Such illusory guidelines do not improve the efficiency of a free enterprise system.[134]

Several alternatives to both the rule of reason and per se methods for determining Sherman Act liability have been proposed. Whether the Court adopts a rule of "per se legality,"[135] "presumed legality,"[136] or a specific series of "filters,"[137] the objectives sought by the Sherman Act would be better served. Further, judicial resources would not be wasted on attempts to apply superficial economic analysis to modern, dynamic market conditions.

Unfortunately, the Supreme Court has not yet met the challenge to "take the earliest opportunity to review its Russian roulette approach to vertical price restraints."[138] Instead, by its *Sharp* ruling, the Court has allowed the burdensome and complex precedents of *Sylvania* and *Monsanto* to remain the standard method for analyzing any vertical agreement.

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132 *Sharp*, 108 S. Ct. at 1520. *See also* Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 759, 763-64 (1984).

133 *See generally* THOMPSON, *supra* note 124, at 529-31 (overview of ramifications when business decisions do not include antitrust considerations).

134 *See* Posner, *supra* note 4, at 15. Referring to the Court's definition in *Chicago Bd. of Trade*, Posner characterized the rule of reason as "[a] standard so poorly articulated and particularized, applied by tribunals so poorly equipped to understand and apply it, [which] places at considerable hazard any restriction that a manufacturer imposes on its dealers and distributors." *Id.* (citing Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)).

135 *Id.*

136 *See* Hay, *supra* note 4, at 436-40.

137 *See* Easterbrook, *supra* note 121, at 157-168.

138 *Sharp*, 780 F.2d at 1222 (Jones, J., concurring). In her concurring opinion, Judge Jones, regarding vertical price restraints, articulated that:

> The larger conclusion that can be drawn from the scenario of this case is that assuming the continued variety, vitality and innovation of the American free enterprise system, it is unrealistic to conclude that measures taken by a manufacturer to enhance his product's marketability, whether related to price or not, are anticompetitive unless they are part of a program to enforce a manufacturer- or dealer-level cartel.

Id. at 1221 (Jones, J., concurring).