The Heritage Foundation Issue Bulletin

No. 137 | The Heritage Foundation • 214 Massachusetts Avenue • N.E. • Washington, D.C. • (202) 546-4400

February 12, 1988

TINKERING WITH ANTITRUST LAW, CONGRESS THREATENS CONSUMERS AND COMPETITIVENESS

U.S. antitrust law has been improving dramatically for more than a decade. Legislation now pending in Congress, however, threatens to turn back the clock on a major part of the antitrust gains by hindering important business practices beneficial to consumers and to U.S. competitiveness.

Spurred by the work of antitrust scholars, such as federal appellate judge Robert Bork, courts have become increasingly flexible and willing to consider the real economic effects of their antitrust decisions. They have been rejecting the rigid, dogmatic approach that had marked antitrust law for most of this century.

The trouble is, Congress now is flirting with a return to the old rigidity. The lawmakers are considering bills to limit the ability of U.S. manufacturers to decide who will distribute their products. Supporters claim the legislation merely involves a change in evidentiary standards in an arcane part of the antitrust law. In reality, it would do much more than that. It could cripple the ability of manufacturers to market their products efficiently--especially in new high-technology fields--diminishing U.S. competitiveness. The real cost, of course, would be borne by consumers, who would receive lower-quality services from product distributors.

To the Detriment of Consumers. Two versions of this legislation are now pending: S. 430, which soon will be considered by the full Senate, and H.R. 585, which already has passed the House of Representatives. Both bills would: 1) limit the ability of manufacturers to terminate agreements with dealers because of the way the dealers priced their products, and 2) write into law a prohibition of resale price maintenance (or RPM) agreements.

Though often misunderstood, "resale price maintenance" is simply a restriction by manufacturers on the prices at which retailers can sell the manufacturer's products. For instance, a VCR manufacturer may wish to require retailers, in return for being allowed to market its products, to sell at no less than the suggested

manufacturers from liability. The Supreme Court's decision in this case is expected to clear up the legal standing of RPM policies under current law.

PENDING LEGISLATION

The bills pending in Congress would overturn the changes in antitrust policy resulting from the *Monsanto* and *Sharp* cases, making it much easier for an aggrieved distributor to sue a manufacturer. One bill, H.R. 585, passed by the House of Representatives on November 9, would write into law the *Dr. Miles* rule that an agreement between a manufacturer and dealer limiting resale prices is illegal under the Sherman Act. Further, it would declare that, whenever supplies to a dealer are terminated by a manufacturer "in response" to complaints received from another dealer about the first dealer's prices, a jury could infer that an illegal conspiracy existed. No actual agreement, in other words, need be proved.

The Senate bill, S. 430, introduced by Ohio Democrat Howard Metzenbaum, was approved by the Judiciary Committee on August 6. As would its House counterpart, it would put the ban on price maintenance into statute. In contrast with the House bill, however, it would allow juries to infer the existence of a conspiracy only when one dealer suggests, implicitly or expressly, that a manufacturer take steps to curtail price competition by another dealer, and the manufacturer ceases supplying the other dealer "because of" that suggestion. The bill specifies that the suggestion be a "major contributing cause" of termination. This is meant to be a stricter standard than the House bill's, though the practical difference is not clear. This bill is expected to be taken up soon by the full Senate.

THE RATIONALE FOR RESALE PRICE MAINTENANCE

At first glance, it may be difficult to see how consumers could be hurt by this legislation. Indeed, resale price maintenance may seem to be just another form of price fixing, which prevents dealers from reducing the prices that they charge to consumers. On closer inspection, however, the issue turns out to be much more complex.

Traditional Explanations for RPM

Manufacturers do not necessarily profit by fixing the prices charged by their dealers. A higher retail price may help the dealer, but it may be of no particular benefit to the manufacturer; it is the wholesale price paid to him by dealers that is important to the manufacturer. Higher retail prices, moreover, actually hurt manufacturers, since an increase in the retail price reduces the volume of goods sold. In short, a manufacturer has no interest in establishing a cartel for its dealers, since this would decrease the amount that the manufacturer could sell without affecting the price the manufacturer receives from the dealers.

It is thus very unlikely that a manufacturer would pursue an RPM policy merely to allow dealers to charge higher prices.[6] An alternative argument sometimes advanced is that RPM policies are actually disguised cartels among the dealers to increase their own profits. But this does not explain most instances of RPM. For one thing, it is hard to explain why a manufacturer would go along with such a scheme when it has nothing to gain and potentially much to lose. While large individual distributors may be influential, it is hard to imagine them dictating such a policy to a national manufacturer, such as the Monsanto Corporation, especially considering the cost to the manufacturer.

For another thing, it is even doubtful that such a strategy could be very successful in most cases, considering that many manufacturers pursuing resale price policies sell only a tiny fraction of the goods in the market. For instance, in the *Monsanto* case, Monsanto held only 15 percent and 3 percent, respectively, of the markets for the products in question.[7] Thus any attempt by a cartel of its dealers to raise prices would just lead to a loss of business to other brands.

The plain fact is, moreover, that the manufacturers support RPM. It is not something forced upon them. Manufacturers and their trade associations have been and continue to be strong opponents of laws restricting RPM, a strange position if RPM were against their interests. This does not mean, of course, that RPM is never the result of a dealer cartel. But such cartels are rare and do not explain the vast majority of resale price policies.

Assuring Quality Services

The most sensible explanation for RPM is that it enables manufacturers to ensure that their dealers provide high-quality services to consumers. A manufacturer relies upon its dealers not only to distribute its product to the public, but to provide a variety of services along with that product. These services are critical to the product's overall quality. Example: the typical computer dealer must do more than just have boxes of computers on hand: he must have salesmen able to demonstrate the product, advertise in local papers, and inform walk-in customers of the computer's advantages, how it works, and how it differs from other brands. Dealers also are expected by customers to provide delivery and repair services. These services obviously increase the quality of the total product offered to the benefit of the manufacturer, the dealer, and the consumer.

The problem is that the benefits from many of these dealer-provided services do not just benefit the dealer who provides them, they benefit all who sell the product. A customer may go to a "full service" computer store after seeing advertisements paid for by the store, obtain valuable advice and information from the dealer, and then go to a discount dealer and purchase the equipment for a much lower price. Thus it is possible, and common, for one dealer to "free-ride" on services provided by other dealers. This may sound very beneficial to the consumer,

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6. As Robert Bork has stated: "we may safely assume that manufacturers are not moved to engage in that peculiar form of philanthropy." *Op. cit.*, p. 290.

7. 465 U.S. at 756.

and in the short run it is. Yet this puts the full service dealers at a severe cost disadvantage, ultimately forcing them to eliminate many services--to the detriment of the consumer.

Even when no free-rider situation is possible, there can be problems. For instance, gasoline companies or fast food chains rely upon their dealers and franchise holders to keep their facilities clean and attractive to customers and to provide such amenities as clean restrooms and knowledgeable attendants. It is of course unlikely that one gas station or fast food restaurant could "free-ride" off the provision of such amenities by other dealers--customers can go elsewhere if they are not provided. Yet national chains must ensure a certain uniformity of their product if they are to stay in business. If one station or restaurant cuts corners, it can hurt business for the rest.[8]

Resale price maintenance presents a way to solve these problems. By establishing a floor on prices, dealers are unable simply to cut services to the bone and underprice other dealers. Dealers instead are forced to compete with each other through increased services to consumers. The better service they provide, the more business they will get.[9] Of course, price maintenance is not always required; in the majority of cases manufacturers see no need for such strategies. In an open market, however, consumers, rather than federal law, determine what policy is most effective.

PROBLEMS WITH S. 430 and H.R. 585

Given the potential beneficial effects of resale price maintenance, many analysts have called for full legalization of such agreements. Robert Bork, for instance, urges that "every vertical restraint should be completely lawful."[10] Federal courts in the past decade have been moving in this direction, recognizing the value of RPM. In Monsanto and other cases, courts have reduced liability radically for manufacturer-inspired resale price policies, the form of RPM most clearly benefiting consumers.

Rule of Reason. The legislation pending in Congress would reverse this progress. Legal RPM, as supported by Bork, would be thrust out of reach. The legislation even would prohibit courts from examining RPM policies on a case-by-case basis under the "rule of reason" test now applied to manufacturer restrictions on things other than price. Instead courts would be required to consider RPM *per se*, or automatically, illegal in every case.

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8. See Bork, *op. cit.*, pp. 435-436.

9. For a more detailed catalogue of the potentional efficiences from resale price maintenance, *Ibid.*, pp. 435-439.

10. *Ibid.*, p. 288. A vertical restraint is a restriction between a manufacturer and its distributors, as opposed to a "horizontal" restriction between competitors.

Worse still, much of the important reform already achieved would be lost. Instead of a firm standard requiring an agreement between a manufacturer and a dealer before liability can be found, a vague standard would be substituted, imposing liability when termination is "because of," or merely "in response to," another dealer's complaint.

This language is very different from that required under current law. Instead of requiring an actual agreement, all that would be needed, if the legislation passes, is a complaint that results in manufacturer action against a dealer. Even a manufacturer which decides on its own not to supply dealers who depart from suggested prices could find itself subject to liability if it happened to be informed of the problem by another dealer. As a practical matter, this would make it extremely difficult for manufacturers to pursue RPM policies, since the best source of information that manufacturers have regarding free-riding dealers often is other dealers.

Handicapping High Technology. The legislation, moreover, would put manufacturers in a straitjacket even when they were not pursuing any RPM policies. Under the bills, manufacturers would run a risk of being sued whenever they terminated their relationship with a dealer after receiving any communication from another dealer. Thus, according to James Rill, chairman of the American Bar Association's Section on Antitrust Law, even a "manufacturer that unilaterally terminates a customer for poor service or free-riding would run the risk of needlessly being dragged through a jury trial."

The effects of the pending legislation would be far-reaching. It could handicap seriously efforts by manufacturers to insure that consumers are provided the information and services they need to make wise purchase decisions and to receive proper after-sales service. The greatest impact could be in high-technology fields, which constitute an increasingly important component of the U.S. economy. While providing information and services is important in marketing many kinds of products, it is critical for such complex and relatively new goods as personal computers, video cassette recorders, and communications equipment. Just when policy makers are so concerned about the competitiveness of the U.S. economy, this new law could hobble the distribution of the most technologically advanced products available to U.S. consumers and businesses.[11]

Reducing Competition. The proposed antitrust law also very likely would reduce economic competition in the U.S. rather than enhance it. New products and brands often require considerable promotion, including public education and innovative marketing, before being accepted by consumers. To ensure that job is done properly, it is particularly important that manufacturers of new products can coordinate their marketing efforts with those of the dealers. By making it more difficult for a manufacturer to control distribution, H.R. 585 and S. 430 would hinder such new entry into markets. This would reduce competition by favoring well-known manufacturers already dominating the market.

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11. Letter from James Rill to Senator Strom Thurmond, dated December 4, 1987, explaining why the ABA opposes S. 430 and H.R. 485. See also, Bert Rein, "Congress Squares Off With Administration in Antitrust Battle," *Legal Times*, October 19, 1987, pp. 26-27.

Although the bills are meant to help independent distributors, the legislation may put many out of business. The reason: as manufacturers find it more difficult to market their products through independent dealers, a larger number would market their products directly, through wholly owned subsidiaries, giving them a freer hand in marketing policies. The result would be fewer business opportunities for independent distributors.

The only real beneficiaries of the proposed law may be the lawyers. Because of the law's broad and vague terms, almost every dealer terminated by a manufacturer would find himself with a potential antitrust case. Antitrust lawyers once again would find themselves with plenty of new and lucrative work--at the expense, of course, of the U.S. consumer.

CONCLUSION

There have been enormous improvements in the antitrust law over the last decade, as courts have begun to consider the economic effects of their decisions. This trend benefits American consumers. H.R. 585 and S. 430, however, threaten to erase the gains made in this vital area of the law by interfering with the right of manufacturers to choose how and by whom their products will be distributed. In so doing, the Congress is ignoring a generation of economic thought on this issue.

If passed, this legislation would interfere with the capability of U.S. manufacturers to ensure that their distributors provide consumers with high-quality services and product information. It especially would hinder efforts to distribute high-technology products, for which dealer services are essential, thereby reducing the competitiveness of the U.S. economy. Probably the only beneficiaries would be the lawyers, who would enjoy a boom in antitrust litigation.

James L. Gattuso
McKenna Senior Policy Analyst in
Regulatory Affairs