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DEPARTMENT OF JUSTICE'S VERTICAL RESTRAINTS GUIDELINES

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE OVERSIGHT ON DEPARTMENT OF JUSTICE'S VERTICAL RESTRAINTS GUIDELINES

JULY 16, 1985

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TUESDAY, JULY 16, 1985

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:07 a.m., in room, SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Present: Senators Metzenbaum, Specter, Simon, Grassley, and McConnell.

Staff present: Kenneth Starling, antitrust counsel; Alice Milder, counsel; Steven Ross, minority counsel; Victor Maddox, legislative assistant; Neal Manne, counsel; and Christopher Dunn.

OPENING STATEMENT OF SENATOR MITCH McCONNELL

Senator MCCONNELL. The committee will come to order.

Chairman Thurmond is in a meeting and will be along shortly, and has asked me to begin the hearing in his absence. It is a hearing on the oversight of the Department of Justice's vertical restraints guidelines, and our first witness is our colleague from New Hampshire, Senator Rudman.

And I might say before he begins, I am going to insert in the record an opening statement of the Chairman and of my own at this point.

[Statements follow:]

OPENING STATEMENT BY CHAIRMAN STROM THURMOND

We are conducting this oversight hearing today to consider the Vertical Restraints Guidelines released by the Department of Justice on January 23 of this year.

"Vertical restraints," in antitrust law, are agreements between firms operating at different levels of the manufacturing or distribution chain that restrict the way in which firms purchase, sell or resell goods. An example of a vertical restraint is a dealer's agreement with a manufacturer that the dealer will have the exclusive right and duty to market the manufacturer's product in a given territory, Vertical restraints can be of two varieties—price restraints and nonprice restraints. In 1977, the Supreme Court recognized that nonprice restrictions can promote competition among different brands of products; accordingly, the Court ruled that the antitrust legality of nonprice vertical restraints should be judged by a Rule-of-Reason analysis. That decision, *Continental T.V., Inc. v. G.T.E.-Sylvania,* changed the law and created a certain amount of uncertainty and confusion about how to analyze vertical restraints.

In an effort to reduce some of that uncertainty, the Justice Department issued a statement that explains its enforcement policy in this area of law. The statement itself indicates that it is confined to nonprice vertical restraints and that it sets forth general principles used by the Department in analyzing such restraints. The

Department indicated that its intention in releasing the Guidelines was to assist the business community in planning, so that businesses could design their distribution schemes to employ lawful arrangements while avoiding unlawful ones.

Despite this intention, the Department has sparked a certain amount of controversy with its Guidelines. Critics charge that the Guidelines deviate from prevailing court rulings in some respects and that they may influence future court decisions. Congressman Fish has introduced a sense-of-Congress resolution that would express Congressional disagreement with the Vertical Restraints Guidelines. Therefore, it is appropriate for the Committee, with its oversight responsibility for antitrust enforcement, to hear testimony about these Guidelines.

OPENING STATEMENT OF SENATOR MITCH MCCONNELL

Mr. Chairman, I appreciate the opportunity to be here today to participate in this hearing by the committee to examine the guidelines issued by the Department of Justice for the imposition and prosperity of vertical restraints imposed in the marketplace. The subject matter is, I believe, among the most complex that this committee encounters, and it is not subject matter that I necessarily come to with the broadest or most comprehensive background of those on the committee.

Yet it may be that to be effective in this oversight capacity, one ought not to have the kind of background in antitrust analysis that comes from a lifetime of study and practice in the field. If a lawyer of general background and experience cannot evaluate the guidelines, then the guidelines themselves are perhaps too complex. After all, the Department's role in advising businessmen about the vagaries of vertical restraints is to inform not only the large businesses that impose the restraints, but also the relatively small businesses that often find themselves subject to them. For these businesses, it is a significant burden to hire competent counsel in the antitrust field, and all of us have an interest in seeing that the burden on American businesses of complying with the antitrust laws, however we may view those laws, is made easier, not more difficult.

I have no preconceived notions at this point about the wisdom of the more technical aspects of these guidelines, and come to this hearing with the intention of reviewing them from an objective point of view. No point is served by grinding an ideological ax at this hearing, and I have no such intention. Rather, all of us on the committee ought to consider whether the guidelines are an appropriate exercise of the Departments's authority within the bounds of the existing law and, whether they accomplish the goals of clarification and explanation for which they were promulgated.

Mr. Chairman, I look forward to the testimony of the witnesses, including that of the distinguished Senator from New Hampshire, and commend your leadership in conducting this hearing.

Senator MCCONNELL. I am sorry, Senator Metzenbaum. Do you have an opening statement?

Senator METZENBAUM. Yes, thank you.

First of all, I want to thank the chairman for calling this hearing at my request to exercise this committee's oversight of the Justice Department's vertical restraints guidelines.

Frankly, if the Justice Department's radical views become law, there will be higher price markups, fewer discount stores, and a reduced opportunity for comparison shopping.

I must admit, I am very disappointed that the administration has published these guidelines. The administration claims to be for free enterprise, but free enterprise does not just mean freedom from governmental regulations. Free enterprise also means free and open competition in the marketplace. These guidelines encourage private restraints of trade which limit free and open competition.

I cannot think of any action of this administration that has been more disappointing to me than the total reversal of support for strong and effective enforcement of our antitrust laws. For an administration that came into power advocating and saluting and standing under the flag of free enterprise, they have done more to turn the clock backward than any administration in the history of this country, including all Republican and Democratic administrations before them.

I am pleased to announce that I am joining my distinguished colleague from New Hampshire, Senator Rudman, who is here as our first witness, in introducing today a "sense of the Congress" resolution expressing congressional disapproval of these vertical restraints guidelines. This resolution is identical to one introduced in the House of Representatives by no less a person than Congressman Hamilton Fish, the ranking Republican on the House Judiciary Committee.

The commendable efforts of Senator Rudman and Congressman Fish demonstrate that Republicans as well as Democrats recognize that strong antitrust enforcement is an essential element of preserving our free enterprise system.

Some administration spokespersons have defended these guidelines as consistent with current judicial precedent and as a worthwhile contribution to the "marketplace of ideas" concerning antitrust policy. Mr. Chairman, if these guidelines were a consumer product, the Justice Department could be sued for false advertising. It is an abomination to call these a fair submission in the "marketplace of ideas."

The guidelines state, for example, the agreements among competing dealers to restrict competition are not per se illegal, as long as the dealers only sell one brand of a product. In other words, if a group of dealers selling only Chevrolets conspired to eliminate a discount Chevy dealer, their conspiracy would not be automatically illegal. Not only is this position shockingly anticonsumer; it directly contradicts the Supreme Court's decision in *U.S.* v. *General Motors Corp.*, holding such a conspiracy to be automatically illegal.

The guidelines are also deceptive in stating that they have no effect on the laws against resale price maintenance, which has been condemned both by the Supreme Court and Congress as per se illegal. Studies demonstrated that abolition of State fair trade laws which permitted resale price maintenance saved consumers $2.1 billion. But the fine print of the guidelines reveals that price-fixing which is combined with our restraints will not be per se illegal. As a result, manufacturers will be able to artificially prop up retail prices with impunity.

Under the Department's guidelines, it will be much easier for manufacturers with highly desirable consumer products to force consumers to buy from one authorized dealer, instead of comparison shopping for the best value.

As far as the Department is concerned, Ford or Chrysler could designate one dealer for an entire metropolitan area without objection. Competition among dealers of the same brand is irrelevant, according to the Department. Ask any consumer who has recently purchased a car or a television or a stereo, whether intrabrand competition is irrelevant.

In the real world, in contrast to the Department's fancy theories, consumers save millions of dollars each year from intrabrand competition. I totally agree with Donald Baker, who was President Nixon's antitrust chief. Mr. Baker recently wrote that the guidelines reflect, "more the flavor of the seminar rooms at the University of Chicago than the historical jurisprudence of the Federal courts."

Because the Justice Department's views are so contrary to established judicial precedent and basic notions of free competition, I am confident that they will be rejected by the courts. This resolution will hopefully bolster the efforts of litigants seeking to retain traditional, proconsumer enforcement of the antitrust laws.

Mr. Chairman, Senator Rudman and I are also introducing legislation today to complement this resolution in promoting vigorous retail competition. This bill would clarify antitrust doctrine to ensure that discounters who are cut off by a manufacturer because of a conspiracy between the manufacturer and competing high-price retailers do not have special burdens in proving such a conspiracy in court.

Prior to last year's Supreme Court decision in *Monsanto*, juries in conspiracy cases were free to find a conspiracy from all forms of circumstantial evidence. For example, if a discounter was terminated by a manufacturer immediately following complaints by competing high-priced retailers, and the manufacturer offered no credible legitimate reason for the termination, a jury has been able to find a conspiracy in restraint of trade. However, *Monsanto* suggested that this evidence would not be sufficient; the case would be dismissed before the jury could even consider it.

The *Monsanto* decision makes it much more difficult to prove vertical price fixing. Our bill would adopt the approach of three courts of appeals, which was advocated to the Supreme Court by 46 State attorneys general—where a dealer is terminated following complaints by competing retailers, a jury may infer a conspiracy.

I am pleased that Senator Rudman, himself a former State attorney general, has joined me as a cosponsor of the Retail Competition Enforcement Act of 1985, and I hope that the chairman will process this bill quickly through the Committee, so that consumers can continue to receive the benefits of full and vigorous retail competition for desirable products.

Mr. Chairman, I appreciate your courtesy in being here this morning, and your cooperation, and I am looking forward to hearing the testimony of my distinguished colleague, Senator Rudman.

Senator McCONNELL. Thank you, Senator Metzenbaum.

Senator Grassley?

Senator GRASSLEY. Mr. Chairman, I am just going to insert my statement, but I want to compliment Senator Rudman, and his cosponsor, Senator Metzenbaum, for continuing to blaze the trail they started last Congress on this issue. And I wish to insert my statement, which acknowledges this effort.

Senator McCONNELL. Without objection, the statement will be inserted at this point.

[Statement follows:]

OPENING STATEMENT BY SENATOR CHARLES E. GRASSLEY

Mr. Chairman: Today's hearing regarding the standards used by the Department of Justice in analyzing the competitive effects of nonprice verticle restraints on competition is timely especially in light of today's economic climate.

I understand that the purpose of our hearing is to examine these guidelines, and in part determine their fairness and whether they are appropriate in light of the *Sylvania* case.

It seems in the wake of *Sylvania* there is certainly a need for the Department's position on prosecutions in this area to be made known to the business community. The question remains, however, as to the effect these guidelines may have on certain industries in this country. Of particular concern to me is the possibility of somehow applying these guidelines to price restrains, the result being that the rule of reason would become the standard under which pricing arrangements would be judged.

Congress spoke clearly on this issue last Congress regarding the pursuance of the *Monsanto* case by the Department and we certainly do not wish to retreat from that position.

Thank you Mr Chairman and I look forward to hearing from our distinguished witnesses.

Senator McConnell. Senator Rudman?

STATEMENT OF HON. WARREN B. RUDMAN, U.S. SENATOR, STATE OF NEW HAMPSHIRE

Senator Rudman. Mr. Chairman, thank you very much, and I thank my good friend, Senator Grassley, for those gracious comments.

I want to say to my cosponsor and friend from Ohio, Senator Metzenbaum, that I agree with him totally that this is very much of a bipartisan effort; as a matter of fact, he is following in a great Republican tradition, since the genesis of the antitrust laws, of course, lies in the Theodore Roosevelt administration, which I am wont to point out to many of my liberal friends.

Senator Metzenbaum. Could I interrupt just to point out that John Sherman, author of the Sherman Act, came from Ohio. [Laughter.]

Senator Rudman. No one ever gets the last word with Senator Metzenbaum.

Mr. Chairman, I want to thank you and other members of the Judiciary Committee for holding this oversight hearing on the important subject of the Department of Justice vertical restraint guidelines.

As you know, I have long had an interest in the antitrust enforcement policies of the Justice Department, especially policies relating to resale price maintenance and other forms of vertical restraints.

I appear before you today because I am concerned and disappointed that the Department of Justice has chosen to release a set of policy guidelines which in several significant respects are contrary to existing law and which, if they remain unchanged, could seriously undermine the vigorous competition between competing resellers which is so important to a robust economy and low consumer prices.

As a result of this concern, my distinguished colleague from Ohio, Senator Metzenbaum, and I will today introduce a "sense of the Congress" resolution disapproving the guidelines. This resolution, which is identical to a resolution introduced in the House earlier this year by Congressman Fish, will make clear that the guidelines do not reflect existing law and should be given no force and effect in the courts of this land.

PRIOR RPM ENFORCEMENT POLICY

I intend to discuss the guidelines and the resolution concerning them in more detail later in my testimony. However, I want to first take just a moment to put the guidelines in context by reviewing recent Justice Department resale price maintenance enforcement policy.

Mr. Chairman, as you may recall, it was in 1983 that the Antitrust Division of the Justice Department, then under the leadership of William Baxter, signalled its intention to disregard the well-established legal principle that resale price maintenance is per se unlawful. This was done by filing an amicus brief with the Supreme Court in the *Monsanto* case, urging the Court to overrule its prior decision and abandon the per se rule. Ultimately, it took congressional action to make clear to Mr. Baxter that his job was to enforce existing law, rather than to ignore it in pursuit of his own economic theories.

Since that time, I have been assured repeatedly that the Antitrust Division intends to enforce the per se rule. Yet I also know that despite these assurances, the Department has failed to bring a single resale price maintenance enforcement action in the last 4 years. Given this dismal record of enforcement, I suggest that any pronouncements from the Antitrust Division concerning vertical restraints merit very careful consideration.

THE GUIDELINES

So far I have been speaking principally about resale price maintenance, whereas the guidelines purportedly deal only with nonprice vertical restraints.

Why the concern with resale price maintenance? The answer is quite simple. While the Justice Department pays lip service to the continued validity of the per se rule in resale price maintenance cases, the guidelines define nonprice vertical restraints in such sweeping terms that virtually all resale price maintenance cases would have to be judged under the rule of reason rather than the per se rule.

Let me give you an example of what I mean. In section 2.3, the guidelines state that,

> If a supplier adopts a bona fide distribution program embodying nonprice restraints, these guidelines will apply unless there is direct or circumstantial evidence—other than effects on price—establishing an explicit agreement as to the specific prices at which goods or services would be resold.

Now, as anyone who is familiar with this area of the laws knows, the idea that an explicit agreement to set specific prices is required to justify the use of the per se rule is directly contrary to well-established law. Even more important, as anyone who has ever prosecuted a conspiracy case can tell you, explicit agreements occur rarely in conspiracies, and such agreements are almost never—I say, almost never—provable in court. The reason is that conspiracies are, by their very nature, secret, and more often are the result of a tacit understanding than an express agreement.

As a former attorney general of the State of New Hampshire, I oversaw the prosecution of many conspiracy cases, and I can recall very few in which an explicit agreement was proved at trial.

As a result of this experience, I can tell you that if this requirement were ever adopted by the courts of this country, you could forget in most cases about prosecuting resale price maintenance actions under the per se rule.

Of equal concern to the statement that only explicit agreements to fix resale prices will be prosecuted under the per se rule is the statement in the guidelines that even explicit price restraints will be judged under the rule of reason if they are ancillary to nonprice restraints which are plausibly related to the achievement of efficiencies in distribution.

Statements such as those, however, are dangerous, not simply because they are contrary to law, but also because they in fact invite the would-be price-fixer to evade the law by hiding his price restraints under the cover of "plausible" nonprice restrictions.

PURPOSE OF THE GUIDELINES

There is a final point to be made when considering these guidelines, and that is they were never intended as merely an expression of Justice Department policy. Instead, a fair reading of the guidelines and numerous public statements, of Department of Justice officials about the guidelines make clear that they were intended as a guide to the law of vertical restraints for both business planners and the courts, as well as expression of Justice Department policy.

Mr. Chairman, it is bad enough that these guidelines reflect the thinking of the Antitrust Division on how vertical restraints cases ought to be evaluated. What is even worse is that the Department is urging business planners and the courts to follow its misguided policy with respect to vertical restraints.

Senator Metzenbaum has said that if the guidelines were a consumer product, the Justice Department could be sued for false advertising. I would phrase it a little differently. In my view, if a lawyer advises his client about vertical restraint policies on the basis of these guidelines, he had better have a very good, high-limit, malpractice insurance policy.

THE RESOLUTION

The resolution which Senator Metzenbaum and I are introducing today addresses the problems created by the guidelines by doing three things: first, it expresses the sense of Congress that the guidelines do not reflect existing antitrust law—I believe that is only stating the obvious; second, it calls upon the Justice Department to recall the guidelines and not reissue them until interested parties are given an opportunity to comment on the policies expressed in the guidelines, and third, it clearly states the intent of Congress that any antitrust policy guidelines issued by the Department of Justice cannot have the force of law, and therefore, cannot supersede existing antitrust law regardless of the extent of public participation in the formulation of the guidelines.

Mr. Chairman, I recognize that the law of vertical restraints is not in all cases crystal-clear, and I in no way intend that this resolution be viewed as an impediment to the issuance of new guidelines which comport with existing law. Instead, the resolution is directed at the present guidelines because they confuse rather than clarify the law of vertical restraints and because they endorse an economic system in which manufacturers make all the important decisions about resale prices and vigorous competition between independent resellers is irrelevant.

This is simply not the kind of economic system envisioned by the Sherman Act, and it is not the kind of economic system which the United States of America or the U.S. Congress should endorse.

Mr. Chairman, thank you again for holding the hearing and for giving me this excellent opportunity to testify on this very important subject to American consumers.

I will answer any questions if I can.

[Aforementioned material follows:]

179914.333 S.I.C.

99th CONGRESS
1st Session S. CON. RES.

IN THE SENATE OF THE UNITED STATES

Mr. Rudman (for himself and Mr. Metzenbaum) submitted the following concurrent resolution; which was ____________________

CONCURRENT RESOLUTION

Expressing the sense of the Congress that the antitrust enforcement guidelines entitled ''Vertical Restraints Guidelines'', published by the Department of Justice on January 23, 1985, do not have the force of law, do not accurately state current antitrust law, and should not be considered by the courts of the United States as binding or persuasive.

Whereas on January 23, 1985, the Department of Justice published a document entitled ''Vertical Restraints Guidelines'', for the stated purpose of explaining Federal policy for enforcing the Sherman Act and the Clayton Act with respect to nonprice vertical restraints of trade;

Whereas such policy guidelines extend beyond the matter of nonprice vertical restraints of trade and propose the avoidance of the per se rule of illegality applied by the

Supreme Court in 1911 in Dr. Miles Medical Co. against John D. Park and Sons Co. (220 U.S. 373 (1911)), to price-related restraints of trade and subsequently applied by the Supreme Court and the Congress on many occasions;

Whereas such policy guidelines are inconsistent with established antitrust law in stating that intrabrand price fixing will not be regarded as per se illegal, contrary to United States against General Motors Corp. (384 U.S. 127 (1966)); stating that restraints on intrabrand competition are of minimal concern, contrary to Continental T.V. against GTE Sylvania, Inc. (433 U.S. 36 (1977)), which requires in such circumstances a balancing of any injury to intrabrand competition against any benefit to interbrand competition; and suggesting that vertical price fixing is lawful as long as such agreements do not set specific retail prices, contrary to existing law which holds interference with the competitive process of setting prices to be per se illegal;

Whereas such policy guidelines state that the Department of Justice may refuse to attribute to corporations the illegal conduct of their low-level employees acting within the scope of the authority conferred upon such employees by such corporations, contrary to the common law of corporate responsibility and agency;

Whereas the general business community would be at risk if it accepted and relied upon such policy guidelines as an accurate statement of existing Federal antitrust laws in the area of vertical restraints of trade;

Whereas such policy guidelines relate to an area in which the Department of Justice has brought no enforcement actions in more than four years and have been published, in part, as an attempt to influence the courts of the United States to pursue a very narrow and limited vertical restraint analysis in deciding private enforcement antitrust cases;

Whereas previous antitrust enforcement policy guidelines issued by the Department of Justice have been given considerable weight by the courts of the United States in evaluating the facts in antitrust litigation;

Whereas the potential impact of the ''Vertical Restraints Guidelines'' on Judges of the United States may be highly prejudicial to discount wholesalers and retailers selling branded goods at competitive prices directly or by mail order; and

Whereas such policy guidelines were prepared and published without regard for procedural fairness, in that affected individuals and groups such as mass retail distributors and consumer organizations were not consulted as to their content: Now, therefore, be it

Resolved by the Senate (the House of Representatives concurring), That it is the sense of the Congress that--

(1) the antitrust enforcement policy guidelines

stated in ''Vertical Restraints Guidelines'', published by the Department of Justice on January 23, 1985--

(A) are not an accurate expression of the Federal antitrust laws or of congressional intent with regard to the application of such laws to resale price maintenance and other vertical restraints of trade;

(B) should not be accorded any force of law or be treated by the courts of the United States as binding or persuasive;

(C) should be recalled by the Attorney General for review and should not be reissued before providing fair procedures to allow public participation in the formulation of such policy guidelines, including public notice and hearings; and

(2) any antitrust enforcement policy guidelines formulated or adopted by the Department of Justice--

(A) cannot and do not have the force of law; and

(B) cannot modify or supersede the antitrust laws, regardless of the fact that public participation may be permitted in the formulation or adoption of such policy guidelines.

179918.124 S.I.C.

99th CONGRESS
1st Session S. ______

IN THE SENATE OF THE UNITED STATES

Mr. Metzenbaum (for himself and Mr. Rudman)
[redacted] introduced the following bill; which was read twice and referred to the Committee on ____________________

A BILL

To amend the Sherman Act regarding retail competition.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as ''The Retail Competition Enforcement Act of 1985''.

Sec. 2. The Sherman Act is amended by redesignating section 8 as section 9 and by inserting after section 7 the following new section:

''Sec. 8. An agreement between a seller and one or more competing resellers to fix resale prices or to terminate, refuse to supply, or fix the prices of another reseller in order to avoid price competition shall constitute a contract, combination, or conspiracy in violation of section 1 of this Act. Such an agreement may be inferred from the termination or refusal to supply a reseller following complaints by one or more resellers concerning price competition.''.

The CHAIRMAN. Senator, we are delighted to have you here and thank you for your excellent statement.

Senator Metzenbaum, do you have questions?

Senator METZENBAUM. Mr. Chairman, you were not here when I made my opening statement, but I just want to repeat in your presence how much I appreciate your going out of your way to schedule this hearing this morning so that, in our oversight responsibilities, we would have an opportunity to deal with this very important subject, and I am very, very grateful to you.

The CHAIRMAN. Well, it is a pleasure to hold it, Senator, at your request.

The Senator from Iowa.

Senator GRASSLEY. Mr. Chairman, I do not have any questions of this witness.

The CHAIRMAN. The Senator from Illinois, do you have any questions? We are glad to see you, Senator.

Senator SIMON. No, I do not have a question. I am sorry I missed the first few minutes of your statement, Senator Rudman—but I have to say I was very much impressed by it. My guess is that as attorney general in New Hampshire, you got into this area somewhat.

Senator RUDMAN. That is correct, Senator Simon, we did.

Senator SIMON. You sounded like you were speaking from experience.

Let me just add a couple of general observations. One is that this kind of a guideline is going to be inflationary in and of itself; there is just no question about it. And the second thing is, we all make great speeches about the free enterprise system. The free enterprise system functions when there is genuine competition. And what these guidelines do is they erode that competition. So I commend you, and I commend my colleague from Ohio for your leadership on this.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Thank you very much, Senator Rudman, and I would be pleased to invite you to come around and sit with us, if you care to.

Senator RUDMAN. Mr. Chairman, I thank you for the invitation. I have another hearing I must get to. But I want to thank you again, Mr. Chairman. It is always a special pleasure for me to appear before the Judiciary Committee, because the subjects that you have here are ones that are very close to my heart.

The CHAIRMAN. Thank you very much. We are hoping sometime you will request to be on the Judiciary Committee, and we would be pleased to have you as a member here.

Senator RUDMAN. I thank you for that compliment.

The CHAIRMAN. Our next witness is the Honorable Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice.

Mr. Rule, we would be very pleased to hear from you at this time.

STATEMENT OF HON. CHARLES F. RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. RULE. Thank you, Mr. Chairman, and members of the committee.

The CHAIRMAN. If you have a long statement, maybe you could summarize it in 10 minutes, and we will put the whole statement in the record.

Mr. RULE. Yes, sir.

I am pleased to be here this morning to discuss the Justice Department's vertical restraints guidelines that were published on January 23, 1985.

The guidelines set out the Department's enforcement policy concerning nonprice vertical restraints—that is, agreements between different levels of the manufacturing or distribution chain that specify the conditions other than price under which firms may purchase, sell, or resell.

As you pointed out, Mr. Chairman, I have a rather lengthy prepared statement which the members of the committee have; I ask that that be read into the record. And I think that statement, along with the guidelines themselves, provide a fairly thorough explanation of the guidelines, their methodology, and their purpose, and I think a careful reading of those will—I am convinced—dispel many of the misconceptions surrounding the guidelines that seem to persist.

I would like to reserve most of the time for questions from the committee, but before answering questions, I would like to make just two relatively brief points.

First, it seems to me it is important that I indicate why we issued the guidelines. First of all and primarily, the guidelines were issued to provide clarity and certainty to the business community as to our enforcement policy. It is true that few cases over the last three administrations have been filed in this area, but we in the Division do continue to investigate issues that involve vertical questions and vertical restraints in various contexts, and it is important that those out in the business community understand our policy.

Equally, if not more important than indicating to the business community what our policy is, we felt that it was important to lay down in some detail our policy to the staff lawyers and economists in the Department who have to investigate possible violations of the antitrust laws.

We felt that it was important that they have a road map as to when to bring cases so that they did not ignore entirely the area of vertical restraints, nonprice vertical restraints. We think that there are times when those restraints can be anticompetitive, and that it is appropriate for us in the Division to bring cases in those circumstances. We also think, however, that in deciding whether to bring those cases, we have to state clearly to the economists and lawyers what the circumstances are and which cases are appropriately brought.

In addition—and I am not going to deny this—we also hoped that the structured rule of reason that was set down in the guidelines would provide some guidance for the courts in developing a rule of reason consistent with the pronouncements of the Supreme Court over the last eight or so years since *Sylvania*. Since that time, lower courts have really groped around in the dark, in trying to develop an objective rule of reason that is easy to use—with some success, but, I think, limited success. And there is a need, we believe, to add greater certainty in the courts and to provide a framework for the courts to develop an analysis that can distinguish procompetitive from anticompetitive vertical restraints.

It is true that the guidelines emphasize the procompetitive benefits of nonprice vertical restraints, and it is also true that few nonprice vertical restraints would be found illegal under this standard. But the point that is important to emphasize is that nonprice vertical restraints since *Sylvania* have rarely been found illegal. Indeed, if you look through the cases, there are only two examples of appellate courts affirming a trial court's decision to condemn a nonprice vertical restraint under the rule of reason, and that is entirely consistent with what the Supreme Court laid down in *Sylvania* and reiterated in the recent *Monsanto* case.

We believe that this standard, the rule of reason and the guidelines, will actually improve the analysis of the courts, will allow them to focus on anticompetitive restraints, and condemn those that truly are harming competition.

We also recognize that over time, because they are a first effort, they will be improved, particularly as the courts develop the law in this area, and as folks comment on these guidelines. Indeed, we are looking forward to the outcome of this hearing to get more information on the guidelines and how they are being received and how they might over time be improved.

Second, I want to stress once again that the guidelines do not apply to resale price maintenance. We have recognized, at least over the past year, that resale price maintenance remains per se unlawful under Supreme Court precedent; and that we will recognize and enforce the law as it currently exists. The simple fact is that the guidelines try to reconcile the *Dr. Miles* decision, in which resale price maintenance was declared to be per se unlawful, with the doctrines arising out of *Sylvania* and the *Colgate* case, which is almost as old as the *Dr. Miles* case itself. The fact is that several courts have recognized since *Sylvania*—indeed, *Sylvania* and *Monsanto* themselves, particularly *Monsanto*, so recognizes that the normal rules of conspiracy that are developed in horizontal cases, that I would never argue should be changed, and indeed that we use frequently in prosecuting horizontal price-fixing cases, are simply not appropriate in vertical price-fixing cases, because generally, those doctrines for proving conspiracy in horizontal cases rely in large part on effects on price. But as the Supreme Court has recognized, frequently, in fact in almost all cases, nonprice vertical restraints, even the ones that benefit consumers, are going to have some effect on price.

As the 10th circuit pointed out in the *AAA Liquors* case, and I am quoting, "All vertical arrangements affecting price do not constitute resale price maintenance agreements." And the Supreme Court in *Monsanto,* again quoting, said, "If an inference of an agreement on resale prices may be drawn from highly ambiguous evidence, there is considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded."

Given that, we felt that it was important to try to draw the line consistent with the holding in *Monsanto* and the holding by numerous lower courts, so as to distinguish resale price maintenance cases, which remain per se illegal, from nonprice vertical restraints which, according to Supreme Court precedent, have to be judged under a rule of reason. And that was our guiding motivation, if you will, in drafting that section of the characterization section of the guidelines that explains the difference between price and nonprice vertical restraint.

Having said that, I thank the Senators for inviting me here today, and I will be happy to answer any questions that you might have.

The CHAIRMAN. Mr. Rule, as a government expert in antitrust law, would you characterize the area of vertical restraints in antitrust law as one in which there has been uncertainty and confusion, and if so, why?

Mr. RULE. Yes, sir. I think there has been. The law of vertical restraints really got its inception in the *Sylvania* case in the late seventies, that overturned the *Schwinn* doctrine that said that nonprice vertical restraints were per se unlawful.

It is terribly unclear in the law as to what a rule of reason means. If you go back to the explications of a rule of reason by the Supreme Court, the Court essentially seems to invite all manner of evidence without putting any, if you will, flesh on the bones, and not even providing the bones, of the rule of reason.

So the law is highly uncertain. It is very difficult for the courts on a case-by-case basis to develop that sort of framework. I think they are moving in that direction, and indeed, these guidelines reflect the movement of the cases interpreting the rule of reason. But it is not just we in the Department of Justice, or even those in the defense bar, that recognize the uncertainty and lack of clarity in this area. No less a venerable Democratic appointee than Dean Pitofsky at Georgetown has recognized how confused and confusing the law is after *Sylvania* in this area, as well as in the area of providing evidence for an agreement; I think one of your next witnesses, Professor Sullivan, has also commented on the great deal of confusion in the area.

So I think generally folks in the antitrust bar recognize the state of confusion, the lack of clarity, and the uncertainty that characterizes this area of the law.

The CHAIRMAN. Mr. Rule, to your knowledge, have the Justice Department and the Federal Trade Commission published policy statements on various aspects of antitrust law enforcement in the past?

If so, have these statements been generally understood by the bar and business community as advisory descriptions of current policy?

Mr. RULE. Yes, sir, we have. There is quite a list of statements that the Antitrust Division has published. There are also a number that the Department of Justice and other units, components of the Department of Justice have published. Just a few of those are the merger guidelines that were originally published by Don Turner, who was the Assistant Attorney General in the late sixties, under President Johnson, that were then revised in 1982 by William Baxter, and again, in 1984, by Paul McGrath.

There are the guidelines on joint research and development that were published under John Shenefield and Sanford Litvack in the previous administration, as well as the Guide to International Operations that was published by that same administration.

The ability to publish guidelines, I think, is very important to the business community, because the fact is that the Department of Justice and the FTC play an important role in enforcing the antitrust laws. And our views on the law are very important. They are not the only game in town. There are private attorneys general out there. But we believe it is important to clarify the law, to clarify our enforcement of that law so as not to hide the ball from the business community and from others who are interested in the antitrust laws, so that they know where they stand when they enter into a transaction, and they know when they will be challenged, and they know when they will not.

The CHAIRMAN. Mr. Rule, do the vertical restraints guidelines disclose that they are only advisory statements of current enforcement policy?

Mr. RULE. Yes, sir, they do. We have tried to make it very clear in the guidelines themselves, and also in the press release that accompanied the guidelines, that they are only a statement of our enforcement policy, that they are not designed to change the law, and there is no intent to change the law with the guidelines. They simply indicate when we will challenge nonprice vertical restraints.

The CHAIRMAN. Mr. Rule, are there any publications in which the Justice Department routinely summarizes the positions it has taken in briefs on a particular legal topic—for example, on nonprice vertical restraints—and do your guidelines and policy statements serve this purpose?

Mr. RULE. I think they do. As you recognize, Mr. Chairman, we have in the past, and we will continue in the future, to file amicus briefs. That tradition stretches back to previous administrations, and it is an important function that we in the Antitrust Division fulfill.

The positions we take there sometimes are controversial, and we do try to indicate in those briefs what our policy is. And we also try to make those statements consistent with the other policy statements we have issued, such as the merger guidelines. The merger guidelines are frequently cited in amicus briefs that we file, and I have no doubt that we will be citing these vertical restraints guidelines in upcoming amicus cases.

The CHAIRMAN. Mr. Rule, to what extent do the vertical restraints guidelines synthesize court decisions in this area of law?

Mr. RULE. What we tried to do was be consistent with all the Supreme Court decisions, and I think we are, and to synthesize the trend there. They largely reflect the decisions by the lower courts. For example, one of the—I guess it has turned out to be the most controversial aspect of the guidelines—the statement that if a supplier adopts a bona fide distribution system, and that involves both nonprice and price restraints, we will treat the entire system under a rule of reason if the nonprice restraints are at the heart of the distribution system and the price restraints are merely ancillary to those nonprice restraints. That is a doctrine that was developed in the First Circuit in a case after *Sylvania,* and that has been cited by the Seventh Circuit. So again, that was not something we made up; it came out of the lower court cases.

Other parts of the guidelines, for example, the market share test, are consistent with lower court decisions and indicate the trend that the courts have been following in the area of the rule of reason.

Having said that, I must recognize that given the myriad of courts that are out there—lower courts, as well as appellate courts, but primarily lower courts—you may always be able to find a decision here and there, even at the appellate court level, that may disagree with some statement in the guidelines; but, also generally, those court decisions will probably conflict with some other appellate court or trial court decision elsewhere in our Federal judicial system.

The CHAIRMAN. Mr. Rule, to clarify and underscore what you said in your statement, do the vertical restraints guidelines apply to price-related vertical agreements, or affect in any way the law or law enforcement with respect to resale price maintenance or vertical price restraints?

Mr. RULE. No, sir, they certainly do not. As we have said time and time again in recent times, unless and until the Supreme Court changes the per se rule against resale price maintenance, that is the law; that is the law we will enforce; that is what we have told our people; that is the basis on which they investigate complaints about resale price maintenance.

The fact that we have not brought many cases, I think, simply reflects the significant penalties against resale price maintenance, that people do not generally engage in resale price maintenance because it is so obvious, and because they can be subjected to treble damages. And the matters that we generally see people complaining about as examples of resale price maintenance are instead simply examples of a manufacturer exercising his right unilaterally to terminate distributors. That is a right that was given to them in the *Colgate* decision in the late 19-teens.

The CHAIRMAN. Mr. Rule, are there any points at which the vertical restraints guidelines take legal positions contrary to current Supreme Court precedents, and if so, why?

Mr. RULE. I know of none, but I would be happy to elaborate—my interpretation of the guidelines, my interpretations of the Supreme Court decisions, are such that these guidelines reflect the Supreme Court's rationale in all those cases and are consistent with the way any case would be decided that came up as a nonprice vertical restraint. I would be happy to talk about any area that the committee may feel is inconsistent with Supreme Court precedent, and I think I can explain why they really are not inconsistent with current Supreme Court holdings.

The CHAIRMAN. Thank you very much.

The distinguished Senator from Ohio.

Senator METZENBAUM. Thank you, Mr. Chairman.

Mr. Rule, I am not sure that you understand where we are coming from, although I do believe you do, but your statement would seem to confuse the issue.

We are concerned about the fact that your guidelines are contrary to existing judicial precedent, and thus they are deceptive by claiming not to change the law; yet at the same time you are saying they are not intended to change the law, you talk about citing the guidelines in filing amicus briefs. So what you would be doing in an amicus brief is you would be quoting yourself to prove how correct your position is.

And then you go on to confuse and say they do not apply to resale price maintenance laws as enunciated by the Court. And yet, as Senator Rudman has so ably pointed out, they do indeed do that by providing some addenda and some ways the per se rule and practically suggest to people out there how to get around the law.

Then you talk about the *Colgate* case, but you totally overlook the fact that the *Colgate* case, as I recollect it, was limited only to a general statement of policy with respect to termination if there were price-cutting, and it had to be that and nothing else. And as soon as there was something else, the *Colgate* case was not applicable.

Now, former Attorney General Smith promised the Congress that no funds during the current fiscal year would be used to try to overturn or alter the per se prohibition against resale price maintenance. However, your guidelines state that their lenient terms, and not the per se rule, will apply unless there is an explicit agreement as to specific resale prices.

Senator Rudman in his opening statement indicated, as a former attorney general, his recognition and the reality that almost never is there an explicit agreement as to resale prices. Frankly, I believe, as does he and others of us who have been interested in this subject, that what you are attempting to do, through the back door, is what you are not able to do and know you cannot do through the front door.

So I would ask you what judicial precedent requires a plaintiff to prove an explicit agreement about specific prices in order to win a vertical price-fixing case?

Mr. RULE. Senator, I think that the *Monsanto* case, along with a number of lower court cases—the one that is quoted is the *AAA Liquors* case, but there is a long footnote that cites other cases for the proposition—indicates that the normal tests that Senator Rudman referred to that are applied to horizontal price-fixing cases simply cannot be applied to resale price maintenance, because of the fact that you have the *Sylvania* doctrine existing side-by-side with the *Dr. Miles* decision. We believe that the standard, that you cannot in effect have a substantive test for distinguishing resale price maintenance or price restraints and nonprice restraints—since, as the Supreme Court has recognized, they both have an effect on price—you have to have a formalistic distinction. And the formalistic distinction that we have in the guidelines, we believe, is consistent with those decisions such as *AAA Liquors* and with the decision in *Monsanto* that indicate that if an agreement on resale price maintenance may be drawn from highly ambiguous evidence, there is considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded. And that is what we were trying to avoid, consistent with those decisions.

Senator METZENBAUM. Now would you answer my question? I understood what you said, but you did not answer my question. I asked you what judicial precedent requires a plaintiff to prove an explicit agreement about specific prices in order to win a vertical price-fixing case.

Now, you quoted some cases to me, but those cases do not require an explicit agreement about explicit prices in order to win a vertical price-fixing case. Now, can you tell me what language, what syllabus, what court decision speaks specifically to the point that you have set forth in the vertical price guidelines?

Mr. RULE. Sure. I think the—I mean, as you well know, as a very able lawyer, Senator, there are times when one paraphrases, synthesizes, what has come out of a number of different decisions, tries to crystallize, in effect, in language what is in those decisions.

Now, the decisions that I cited—the *Monsanto* case, the *AAA Liquors* case——

Senator METZENBAUM. Give me some language from one of those cases.

Mr. RULE. Well, for example—again, I am paraphrasing now——

Senator METZENBAUM. Well, just give me the language of the Court, not your paraphrase.

Mr. RULE. OK. I do not have *Monsanto* right now before me, but there is a statement in *Monsanto* that there must be evidence tending to exclude the possibility of independent activity before an agreement can be found between a manufacturer and its distributor.

There is also the language that I indicated about the concern with highly ambiguous evidence being used to find a resale price maintenance agreement. And while the court did not state exactly in that decision what the line between nonprice and price vertical restraints is, I think that the standard that we lay down in the vertical restraints guidelines is consistent with the holdings of the Supreme Court and with the holdings in lower court cases.

Senator METZENBAUM. So that you are saying that you think that requirement is consistent, but you cannot find a case in which such a holding was made by the courts?

Mr. RULE. Well, Senator, we did not try to go through and write the guidelines in terms of only quoting language from various court cases. What we tried to do—as you know, in legal reasoning, one has to take the ratio decidendi of the various cases, the holdings, the rationale, and try to form legal rules out of it. And that is what we attempted to do in the vertical restraints guidelines. And as I say, I think they are consistent with the holdings of the Supreme Court cases, and are an accurate representation or characterization of a test distinguishing nonprice from price vertical restraints.

Senator METZENBAUM. If a manufacturer agrees with high-priced retailers that he will terminate any discounter without reference to specific list prices, would this not be treated as per se illegal price fixing?

Mr. RULE. If there were an agreement to say, for example, "Look, you guys are going to sell at a certain price, and I am going to terminate anybody who sells at a lower price," then I think that would be illegal, and that would be caught by our guidelines. The problem with saying that any manufacturer who agrees to terminate low-priced discounters is the same sort of problem that the *Monsanto* case tried to address where it said, look, simply terminating a discounter after complaints from distributors is not enough. You should not be able to find an agreement on the basis of that because, in effect, that may erode the right of the manufacturer to the *Colgate* doctrine, which was reaffirmed in the *Monsanto* case.

Therefore, I would say that in that circumstance—again, you know, you have to look at the evidence, and I would not read that—I mean, there is a sentence, and that sentence indicates you would have to interpret a series of pieces of evidence to determine whether or not there was an explicit agreement on specific prices. And therefore, in a particular case, you would have to know more, I think, than that characterization of the evidence to determine whether or not the test laid out in the guidelines was met, and therefore, whether the retail price maintenance was per se unlawful.

Senator METZENBAUM. Under your guidelines is it per se illegal for a group of automobile dealers who only sell Chevrolets to combine to pressure General Motors into eliminating a rival low-priced Chevrolet dealer?

Mr. RULE. The *GM* case, which you are referring to, is a case that—in fact, probably the only case—that I think arguably can be said to be inconsistent with what we were doing in the guidelines.

But let me just clarify for a minute what we were trying to do in that section, distinguishing intra-brand from inter-brand effects.

There, we were talking about an agreement that involved both distributors and a manufacturer that had that vertical element. The concern we had was that because, as the Supreme Court has noted in *Monsanto,* you need continuous communication between the manufacturer and its distributors, those communications, which in horizontal cases are frequently used to promote a conspiracy, would be used to convert a vertical agreement into a horizontal one. It was a concern in *Monsanto,* and it was a concern of ours in the guidelines. So, what we said was that where it is an intra-brand restraint, and where the manufacturer is involved, that the mere communications among intra-brand dealers, and maybe an agreement under normal conspiracy doctrine, should not convert that restraint into a per se violation. And I think that is an important doctrine, because again, that is not saying they are legal; it is simply saying they have to be judged under a rule of reason and condemned when they are anticompetitive. But we were not saying—and there indeed may be situations where you have automobile dealers who get together and agree on price, for example, and that would still be per se unlawful because it does involve price. And indeed, the whole automobile area may be one that is unique, in the sense that in the automobile area, you have the Dealer Day in Court Act and a whole series of different protections that give the dealers authority to in effect coerce manufacturers. But generally, that is not the problem. Generally——

Senator METZENBAUM. Mr. Rule, our time is running, and I am concerned. I claim the prerogative to filibuster around here, and do not allow it to the witnesses.

My question calls only for a yes or no answer. What is your answer? Is it per se illegal for a group of automobile dealers who only sell Chevrolets to combine to pressure General Motors into eliminating a rival low-priced Chevy dealer—yes or no?

Mr. RULE. If I were advising a client, I would say for them to avoid that situation. But I think it is unclear after *Northwest*——

Senator METZENBAUM. Yes or no?

Mr. RULE [continuing]. After *Northwest Wholesalers*, and after a series of Supreme Court decisions involving BMI, ASCAP, and others, I think it is highly questionable whether or not a per se rule would be applied to that fact situation.

Senator METZENBAUM. So your answer is no?

Mr. RULE. That would be my interpretation of how the Supreme Court would handle that fact situation today, yes.

Senator METZENBAUM. And even though that might be directly contradicted by the *General Motors* case?

Mr. RULE. Again, there are certain distinctions between what we say in the guidelines and, I think, what is in the *General Motors* case. But I think that the *General Motors* decision, particularly in light of *Northwest Wholesalers*, where they talk about there being a need to prove market power, and that all restraints are not per se unlawful, indicates that the Court is going in a direction that is much different from the direction it was going in when it decided the *GM* case.

Senator METZENBAUM. Discussing this section of the guidelines, former Antitrust Chief Donald Baker has written that, "Any counselor relying on the guidelines for planning purposes would be doing so at his or her peril in the face of clearly contrary law." How is the business community helped when you advise them to conduct themselves in ways that the Supreme Court has held are clearly illegal?

Mr. RULE. Well, as I say, I do not believe that this is inconsistent with the Supreme Court decisions and how they would come out in any particular area. Moreover, I know for a fact it is not inconsistent with the way that we enforce the law at the Department of Justice. And if businessmen and women and their counselors want to rely on the guidelines, they should rely on it solely as an explanation of how we enforce the law. Over time, courts may tend to move in the direction—or, continue to move in the direction—that the guidelines go, may adopt some of the VRI tests, the coverage ratio tests, that sort of thing, in the guidelines, and hopefully, we will update our guidelines as the law moves, and perhaps over time, not only will people be able to follow the guidelines as an explanation of our enforcement policy, but also as to the way the courts interpret the antitrust laws.

But right now, I think they should only be followed for an understanding of how we enforce the antitrust laws.

Senator METZENBAUM. But you would agree they do not change the law as it is.

Mr. RULE. They do not change the law as it is.

Senator METZENBAUM. And all you are saying is that is what we are going to do, even though the courts may have spoken to the contrary.

Mr. RULE. We are saying that is what we are doing because we believe that is consistent with the current Supreme Court precedent.

Senator METZENBAUM. Your guidelines also claim that location clauses were "always legal"—that is your phrase. But the *Sylvania* case involved location clauses, and the Supreme Court sent it back for reconsideration at the trial court, on the basis of the rule of reason, where the court looks at all the facts of a particular case.

Has any court held that location clauses are always legal?

Mr. RULE. Never in those words Senator. This was in response to comments we got from folks in the private bar, who indicated that the guidelines should be very careful not to cast doubt on the legality of certain vertical restraints that the private bar, over a series of cases, has come to understand to be legal in all circumstances.

Senator METZENBAUM. And with whom in the private bar did you consult?

Mr. RULE. We consulted with quite a few, frankly. We sent an earlier draft of the guidelines to various bar groups—the Philadelphia Bar Association, the Chicago Bar Association, the Los Angeles Bar Association, the American Bar Association, the New York Bar Association, and one of the bars of New York City. We also sent it to a number of individual practitioners—the Assistant Attorneys Generals going back to, I guess, Don Turner, but including Shenefield and Litvack; we sent them to Dean Pitofsky. We sent them to a whole series of academics from all ends of the spectrum. And I cannot remember who precisely gave us that comment, but it was one that we received from more than one group of attorneys before we put it in this set of guidelines.

Senator METZENBAUM. Would you be good enough to supply me and the chairman of the committee with a list of all those to whom you sent the proposed guidelines?

Mr. RULE. Well, to some extent that was—let me give some thought to whether or not, (a) the list can be reconstructed, and (b) the extent to which those communications were confidential. But I will see what I can do to acommodate you, and I will talk to your staff members after the hearing.

Senator METZENBAUM. Did you discuss it at all with any of the legal representatives of the so-called discounters?

Mr. RULE. As I recall, we did not send it to anyone specifically who was generally associated with that group.

Senator METZENBAUM. Did you send it to any who would generally be considered to be consumer advocate lawyers, and some of the consumer advocate organizations?

Mr. RULE. Well, I think that some of the people whose writings and advice we relied upon—for example, we asked Steve Salop, Dean Pitofsky, and others who I would assume, most consider to be consumer advocates, if that is the word for it—one might call them "liberal"——

Senator METZENBAUM. Didn't Dean Pitofsky tell you not to issue it, because he thought they were horrible?

Mr. RULE. Well, I am sure we got a whole range of advice. I mean, it is impossible to—or, I would say it is impossible in this area to develop a consensus document. You asked whether or not we had asked anybody about it; we did. But whether or not there was full agreement, no, I do not think there was. But any time one is trying to do something important, trying to bring order out of chaos where the rules are not clear, there is obviously going to be some difference of opinion. But I think these were an honest reflection of the law, and consistent with the law. Now, some people may not have liked them, and they may not have protected their own sacred cow, but we did consult and got a range of views as to people's impressions of the guidelines.

Senator METZENBAUM. Well, I would like to know, really, what that range was.

Mr. Chairman, I have just asked the witness—and you may have been talking with staff at the moment—if he would provide us with a list of the attorneys or groups to which the guidelines were submitted for comment prior to their being issued. He has indicated in his response that he would think about it and consider it.

I believe it is a matter that the committee has a right to know about, and so I would hope that you, Mr. Chairman, would be supportive in seeing to it that we find out, really, to whom does the Antitrust Department turn when they are going out for new guidelines, or do they just go to one segment of the bar.

The CHAIRMAN. Well, the question is whether that is an internal matter, that they have a right to pass papers and memoranda internally. That question came up, I believe, in Mr. Reynolds' nomination, too. I think an agency has a responsibility to pass memoranda internally, raising points and everything, but as to making them public, I do not see why they have to be made public.

Senator METZENBAUM. But Mr. Chairman, I want to make a distinction——

The CHAIRMAN. Now, as to the advisability of doing that, that is another thing. I think you can ask him whom he talked to, and things like that, but to make their internal memoranda public, it seems to me, might be going too far.

Senator METZENBAUM. I am not asking for internal memoranda. I am talking only about external requests. Nor am I even asking for the specific language of the responses. I only want to know to whom he has turned in order to obtain an opinion prior to his arriving at an opinion. I am just asking for the names. I do not want to know the details.

The CHAIRMAN. Well, if you have a problem with that, then you let us know, and I am certain we can work it out.

Senator METZENBAUM. Very good. That is fair, that is fair.

The CHAIRMAN. I imagine he will furnish you the information, probably.

Mr. RULE. We will certainly be happy to talk with your staff and the Senator and try to cooperate.

Senator METZENBAUM. Mr. Rule, your guidelines also state that profit passover arrangements where a dealer is required to compensate a rival for sales made in the rival's territory are always legal. At least one court of appeals has noted, however, that if the required payment is so high that it effectively bars competition, it may be illegal. What are the precedents you have for support of that portion of the guidelines?

Mr. RULE. There is a footnote, in fact, in the guidelines—let me see if I can turn to it—that states what those precedents are. It is footnote 17, which says—would you like me to read that to you?

Senator METZENBAUM. If it isn't too long.

Mr. RULE. "See *United States* v. *Arnold Schwinn & Company*—the profit passover permitted in final judgment. Compare *Superior Bedding* vs. *Serta*—7 percent passover fee based on gross sales paid to licensees in those territories were made to compensate for advertising and sales expense by that licensee, upheld—with *Eiberger* vs. *Sony,*" which is the case that you indicated, where the profit passover was found to be illegal.

The fact is that since *Sony,* generally, practitioners believe that profit passover clauses are treated favorably by district courts, and again, that is the genesis of that remark.

Senator METZENBAUM. Well, didn't those cases actually hold that in those specific fact situations, that the passover was legal. From those cases, you then concluded in your guidelines that passover agreements are always legal. And that is the thing that concerns me, the fact that you went from the specifics to the generalization. And I do not think the courts have said that.

Mr. RULE. Generally, the courts have not said that they are always legal. What that represents is a series of cases where the courts, after looking at various fact scenarios, have come to the conclusion that in those varied fact scenarios, the particular practice is legal. That is simply again a reflection of the fact that counselors apparently now believe, based on the experience in the courts, that those three types of restrictions pointed out in the guidelines are always viewed as legal by the courts when they are judging them under the rule of reason.

Senator METZENBAUM. Mr. Chairman, I have some additional questions, but I am concerned about the time element, and with your permission, I will submit my questions in writing and assume that the witness will respond.

The CHAIRMAN. The distinguished Senator from Illinois.

Senator SIMON. I thank you, Mr. Chairman.

First, You said you had two objections to the list that the gentleman from Ohio was asking about. One is whether the list can be reconstructed—I assume you keep carbon copies of letters, so that the list can be reconstructed; is that correct?

Mr. RULE. Generally, we keep files.

Senator SIMON. I assume you do in the Justice Department, so that it is not a problem of reconstructing the list.

Second, I would like to just get your response on another matter. Senator Rudman in his testimony says, "The Department has failed to bring a single RPM enforcement action in the last 4 years." He describes it as "a dismal record of enforcement." Is he correct in that assertion?

Mr. RULE. He is certainly correct that in the last 4 years, we have never brought a resale price maintenance case. But I think to say that that record is dismal ignores the past history of the division in bringing resale price maintenance cases; also, it ignores the reality that there are very few resale price maintenance cases—or one would expect to see very few resale price maintenance cases—but more importantly, it ignores the fact that we have sent out a very clear signal to our folks that if they find a resale price maintenance case, we will consider it under the normal criteria that we consider cases.

I guess the best way to put it is if you have got a case, please bring it to us. We have looked at them. They generally turned out to be cases where resale prices were not involved, where there was not an agreement, where there was a unilateral termination by a manufacturer, and the fact is that a lot of people who say, "Gee, you don't enforce *Dr. Miles*," get all upset. They claim we do not enforce *Dr. Miles* when we are trying to enforce it, because they want us to ignore *Colgate* and *Monsanto*. But the fact is that *Colgate* and *Monsanto* are the law, and we have to honor that and obey that law just as much as we have to obey the *Dr. Miles* law.

But if someone has evidence of a resale praice maintenance case, please bring it to our attention. We have investigated a number of cases in the past. But I should caution that even when a past AAG, Sanford Litvack, made it the top priority of his Administration to bring a resale price maintenance case and devoted considerable antitrust resources to looking at resale price maintenance cases, perhaps at the cost of looking at some horizontal price-fixing cases, he found one, just one case, the *Cuisinarts* case. And I think that record speaks fairly loudly, and I think it is unfair to characterize our record as dismal or to question our good faith in following through in what we have committed ourselves to.

Senator SIMON. Do you know in the previous 4 years, the previous 10 years, how many cases were brought?

Mr. RULE. If you go back three adminstrations, you will find that there was a total of seven vertical cases. Those were not all resale price maintenance cases. One was an exclusive dealing case; some were tie-in cases. But there was a total of seven. And that has generally been the record. There have been other vertical cases——

Senator SIMON. You are referring to the Ford administration?

Mr. RULE. Yes.

Senator SIMON. OK.

Mr. RULE. And that is what we have found in trying to search. We do not generally keep our records that way, but in 1983, we did a search—we have investigated others since then—and there have been some cases, for example, generally in the merger area, where certain of our decisions have been based on a vertical-type theory, either based on the investigation or on our decision to block a particular aspect of the merger.

Senator SIMON. What about the Carter administration years; how many enforcement actions were brought?

Mr. RULE. I do not have those seven split up, but that is for the entire three administrations.

Senator SIMON. Well, the seven is for the Carter and Ford years?

Mr. RULE. Right, exactly, yes.

Senator SIMON. You assured both Senator Thurmond and Senator Metzenbaum that you have no intent to change the law, and yet I was just reading from Professor Sullivan's statement who will be the next witness. He says,

To be blunt, the 1985 vertical restraints guidelines move implacably in the wrong direction. They show a blatant disregard for important Supreme Court cases and clearly-expressed Congressional intent. They have the obvious purpose of influencing the outcome of private cases and the probable effect of reducing the likelihood that such cases will be brought, even when existing law supports them.

If I can get to something Senator Metzenbaum was approaching, that is, how do you determine how you are going to draft these guidelines? Do you look at court cases? When you say you do not want to change the law, aren't you in fact trying to bend the law a little bit? Do you start off in a predetermined direction, or do you take a look at the court cases and the law and say, "This is what we ought to do"?

Mr. RULE. One of the things that I think has to be stressed about this area, and that I tried to stress in response to a question from the chairman, is that this is not an area that is totally clear and totally certain. Indeed, if it was, we probably would have been wasting our time drafting guidelines.

What we tried to do in drafting these guidelines was take the best minds of the Division—we have some very fine minds in the Division, both legal minds and economic minds—to search the literature for the academic perspective on this, both legal and economic, and to fundamentally base the entire analysis on what the Supreme Court has said and how that has generally been interpreted by the various courts.

But because of that uncertainty there is no doubt that—for example, you will not find anywhere in the case law a vertical restraints index. You will not find a coverage ratio. You will find courts using a market share test. You will find courts even relying on concentration.

But we had the advantage of being able to spend some time, reflect, and try to develop model guidelines, a thing the courts generally do not do, in deciding cases on a case-by-case basis. In using our experience and the intelligent minds that we have, we had the ability to develop a sort of comprehensive framework within which to fit the policy and notions that the Supreme Court has recently laid down since *Sylvania* and that has been followed by the court of appeals.

So, it is really sort of a conglomerate effort to attain something that first would explain our position in terms of enforcement, and second would try to bring some order out of the chaos that really is the current state of the rule of reason in the vertical nonprice area.

Senator SIMON. My question has really not been answered. I am trying to find out whether you start off with an intent—let's interpret it in this way—or whether you let the law speak for itself.

Mr. RULE. I think we had a happy confluence of the two. I mean, the fact is that the law, we think, is going in the right direction, and the decisions have been made correctly, and we applaud *Sylvania* and *Monsanto*. And in fact, that is consistent with what economic analysis would tell one, and what good, sound legal analysis would tell one. So really, there was not a choice between the two; they were consistent.

I think the Supreme Court has done an excellent job in this area, in interpreting the intent of Congress and applying a consumer welfare prescription to this area, and it is simply a matter of taking that foundation and building a structure on it. That is really what we were trying to do.

Senator SIMON. Thank you.

I have no further questions, Mr. Chairman.

Senator METZENBAUM [presiding]. Senator Specter, do you have any questions?

Senator SPECTER. Not at this moment. I have just joined you.

Senator METZENBAUM. We are pleased to have you.

Thank you, Mr. Rule. Some of the members of the committee may have written questions, and if they submit them, I am certain that you will be pleased to cooperate and respond.

Mr. RULE. Thank you, Senator. I appreciate your attention.

[Prepared statement and responses to written questions follow:]

51-657 O - 85 - 2

STATEMENT OF

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

THE JUSTICE DEPARTMENT'S
VERTICAL RESTRAINTS GUIDELINES

ON

JULY 16, 1985

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Justice Department's 1985 Vertical Restraints Guidelines. These Guidelines explain our enforcement policy concerning nonprice "vertical restraints," arrangements between firms operating at different levels of the manufacturing or distribution chain (for example, between a manufacturer and a wholesaler or a wholesaler and a retailer) that specify the conditions under which firms may purchase, sell, or resell. Before proceeding further, I would like to explain why the Justice Department decided to issue Vertical Restraints Guidelines.

First, the Department wanted to set out its policy concerning the prosecution of nonprice vertical restraints. We believed it was important to the business community that our enforcement policy in this area be clear. However, equally important, the Guidelines spelled out (in a degree of specificity not possible in a speech) to the Antitrust Division staff our case selection criteria. In the past, because Assistant Attorneys General and their deputies have tended to stress the procompetitive benefits of vertical restraints, it was not always clear whether, and if so what, cases the Division's front office would pursue. By clearly setting forth the conditions under which the Justice Department will challenge a nonprice vertical restraint and thereby unmistakably highlighting those vertical nonprice restraints that merit investigation, the Guidelines provide the staff with an investigatory road map that simply did not exist before.

Second, the Guidelines were designed to provide a coherent intellectual framework for the rule of reason analysis required by the Supreme Court in its landmark 1977 Sylvania decision. 1/ Despite the assertions of some critics, they were not intended to change the law. The recognition in the Guidelines of the beneficial nature of vertical restraints merely reflects the Supreme Court's own views as articulated in Sylvania:

> - Such restrictions, in varying forms, are widely used in a free market economy. . . . [T]here is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary. 2/

The Guidelines' recognition of the benefits of vertical restraints and their rather stringent criteria for judging the legality of those restraints provide no greater leniency for nonprice vertical restraints than the law currently provides. After Sylvania, several commentators argued that the effect of the decision was limited and that nonprice vertical restraints would continue to be looked upon with disfavor. 3/ The fact is

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1/ Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

2/ 433 U.S. at 58-59 (1977)(footnote citation omitted).

3/ See Pitofsky, The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions, 78 Colum. L. Rev. 1 (1978)(suggesting airtight nonprice vertical restraints should be illegal per se); In re Beltone Electronics Corp., [1979-1983 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 21,934 (FTC July 6, 1982)(concurring statement by Commissioner Bailey stressing the anticompetitive potential of purely intrabrand restraints, despite a showing of substantial interbrand competition).

those commentators were wrong. The lower courts consistently--almost uniformly--found the nonprice vertical restraints that come before them to be legal. On only two occasions during the eight years since Sylvania have federal courts of appeals affirmed the condemnation of nonprice vertical restraints by trial courts. 4/ Moreover, during the last three Administrations, a grand total of seven vertical cases have been brought by the Justice Department. 5/ And six of those seven cases involved resale price maintenance or tying.

Given this background, the Guidelines do not run contrary to the law or the trend of decisions in the lower courts. Indeed, by setting out a framework for identifying vertical restraints that are anticompetitive, the Guidelines may enable the courts, antitrust enforcers, and private attorneys general better to enforce the antitrust laws against nonprice vertical restraints. There is little question that the contours of the rule of reason as applied to nonprice vertical restraints are very unclear. 6/ We hope that the Vertical Restraints

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4/ For example, in only two reported decisions since Sylvania, Eiberger v. Sony Corp. of Am., 622 F.2d 1068 (2nd Cir. 1980), and Graphic Products Distributors v. Itek Corp., 717 F.2d 1560 (11th Cir. 1983), have nonprice customer or territorial restraints been struck down.

5/ Baxter, Separation of Powers, Prosecutorial Discretion, and the 'Common Law' Nature of Antitrust Law, 60 Tex. L. Rev. 661, 698 n.157 (1982).

6/ In commenting on the Supreme Court's Sylvania decision, Dean Pitofsky stressed that 'by offering only minimal guidance as to how a rule of reason will be applied, the Court has

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Guidelines eventually will help to reduce this costly business uncertainty by emphasizing the fact that the courts do not condemn vertical restraints out of hand and, at the same time, laying out an objective, predictable rule of reason analysis. If the Guidelines provide a basis for adding clarity and certainty to this area of the law, they would be a major success.

The Vertical Restraints Guidelines were not promulgated hastily. Rather, the standards set forth in the Guidelines reflect considerable scholarly inquiry and case analysis by many economists and lawyers, both inside and outside the Antitrust Division. Before issuing the final version of the Guidelines, we sought input from a number of academics, practicing antitrust lawyers, and business groups of varied philosophical persuasions, and we carefully considered their views. We then endeavored to develop a set of Guidelines rooted in sound enforcement principles that would be accessible to practitioners and to members of the business community alike.

6/ Footnote Continued

guaranteed many years of perplexing litigation." Pitofsky, _supra_ note 3, at 38. Dean Pitofsky also stated that a general, boundless rule of reason "has little deterrent effect, produces trials of inordinate length and expense, and often undermines antitrust enforcement." _Id_. at 2.

Let me turn now to the Guidelines themselves. The Guidelines start out by explaining that they focus primarily on two major categories of restraints that may give rise to anticompetitive concerns--territorial and customer restraints and exclusive dealing arrangements. The Guidelines also deal separately with tying arrangements, whereby the purchase of one product is "tied" to the required purchase of a second product. They do not, however, deal with resale price maintenance, and they expressly so state. 7/ As we have explained publicly a number of times during the past year, the Antitrust Division will continue to view resale price maintenance as *per se* illegal unless and until this *per se* rule is changed by the courts.

The Guidelines next address problems of characterization. This morning, I would like to touch upon two ~~of~~ those issues of characterization. 8/ They explain that the Justice Department

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7/ Guidelines n.1.

8/ The Guidelines deal with other characterization issues as well. For example, the Guidelines explain that the Department will analyze dual distribution under the rule of reason. This is consistent with the trend in the case law. *See, e.g.*, Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190 (6th Cir. 1982); Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348 (9th Cir. 1982); Copy-Data Sys., Inc. v. Toshiba America, Inc., 663 F.2d 405 (2d Cir. 1981); United States v. Koppers Co., Inc., 652 F.2d 290 (2d Cir.), *cert. denied*, 454 U.S. 1083 (1981); Abadir & Co. v. First Mississippi Corp., 651 F.2d 422 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir.), *cert. denied*, 451 U.S. 827 (1981). The basis for treating dual distribution as a vertical rather than a horizontal practice is found in the Supreme Court's *GTE Sylvania* decision, where the Court recognized that

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will treat all nonprice purely intrabrand restraints--that is, nonprice restraints involving only dealers of the same manufacturer's brand(s)--as vertical rather than horizontal. Even though, in some cases, purely intrabrand restraints seemingly could be characterized as horizontal because competing dealers act in concert, these restraints can have no effect that could not be obtained unilaterally by the manufacturer of the brand in question. 9/ Purely intrabrand restraints may reflect a manufacturer's attempt to obtain efficiencies in distribution or product promotion--efficiencies that allow its product to compete more effectively with those of other manufacturers. In contrast, restrictions among competitors who produce different brands are more likely to

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8/ Footnote Continued

when a producer elects to market its goods through distributors, the latter are not, in an economic sense, competitors of the producer, even though the producer also markets some of its goods itself. Rather, the distributors are "agents" of the producer, employed because the producer has determined that it can supply its goods to consumers more efficiently by using distributors than it can by marketing them entirely by itself. See Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. at 56 & n.24 (1977).

9/ Every manufacturer has a monopoly over the distribution of its products. That fact, however, does not violate the antitrust laws. See, e.g., United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956); Parsons v. Ford Motor Co., 669 F.2d 308 (5th Cir. 1982); Sports Center, Inc. v. Riddell, Inc., 673 F.2d 786 (1982). Rather, unlawful monopolization requries monopoly power in some relevant product and geographic market, plus the willful acquisition or maintenance of that power to harm competition. See, e.g., United States v. Grinnell Corp., 384 U.S. 563 (1966).

lower economic welfare by restricting competition among different products. Thus, in order to prevent nonprice purely intrabrand restrictions from being improperly analyzed under some sort of per se theory, they should be viewed as vertical arrangements.

Because nonprice purely intrabrand restraints may help bring about procompetitive efficiencies, we believe it would be inappropriate to treat such restrictions as horizontal agreements simply because competing dealers are parties to the agreement. Because a manufacturer's dealers may be in the best position to observe the optimal method of promoting the brand they sell, communications among dealers of the same brand and between them and the manufacturer, concerning, for example, free-riding by individual dealers, may further desirable efficiency goals. As the Supreme Court has recognized, "a manufacturer and its distributors have legitimate reasons to exchange information about the prices and the reception of their products in the market. . . . [M]anufacturers and distributors constantly must coordinate their activities in order to assure that their product will reach the consumer persuasively and effectively." 10/ Accordingly, we believe that it makes sense to treat all nonprice intrabrand restraints as vertical, even where there is evidence of communications among competing distributors.

10/ Monsanto Co. v. Spray-Rite Service Corp., 104 S. Ct. 1464, 1470 (1984).

I should emphasize at this juncture that while the Guidelines stress the procompetitive benefits of nonprice purely intrabrand restrictions, they make no presumption about the legality of any given nonprice intrabrand restraint. If, according to the Guidelines' standards, we determine that a nonprice purely intrabrand restraint has significant anti-competitive effects, it will be challenged. In addition, if, as discussed below, an intrabrand restraint is a "price" restriction, it will not be evaluated under the rule of reason.

Another characterization problem involves deciding whether a given vertical restraint is a "price" or "nonprice" restriction. All vertical restraints, even those that result in substantial procompetitive benefits, may have some effect on price. A manufacturer may quite legitimately be concerned about the level of resale prices in order "to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product" without interference from free riders. 11/ As the Tenth Circuit pointed out in AAA Liquors, "all vertical arrangements affecting price do not constitute resale price maintenance agreements." 12/ "If an

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11/ Id. at 1470.

12/ AAA Liquors, Inc. v. Joseph F. Seagram & Son, 705 F.2d 1203, 1205 (9th Cir.), cert. denied, 461 U.S. 919 (1983)(liquor distiller's system of price supports to wholesaler who in turn offered discounts to large volume dealers not resale price maintenance). See also, e.g., Lewis Service Center, Inc. v.

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inference of . . . an agreement [on resale prices] may be drawn from highly ambiguous evidence, there is considerable danger that the doctrines enunciated in Sylvania and Colgate will be seriously eroded." 13/ Therefore, we believe it is important to avoid characterizing a particular restraint as resale price maintenance merely because it may affect price. Before characterizing a restriction as resale price maintenance--and, therefore, *per se* illegal--we will require evidence of an agreement between a supplier and its distributors to set resale prices. 14/

Further, in accordance with Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883 (1st Cir.), *cert. denied*, 439 U.S. 833 (1978), if a supplier adopts a bona fide

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12/ Footnote Continued

Mack Trucks, Inc., 714 F.2d 842 (8th Cir.), *cert. denied*, 104 S. Ct. 2678 (1984)(manufacturer's system of discounts to enable dealers to meet retail price competition evaluated under the rule of reason); Butera v. Sun Oil Co., 496 F.2d 434 (1st Cir. 1974)(gasoline supplier's discount system whereby supplier credited dealers for discount amount was not resale price maintenance); Sun Oil Co. v. Vickers Refining Co., 414 F.2d 383 (8th Cir. 1969)(allowing a contract formula between two gasoline suppliers in which first supplier sold to second supplier and guaranteed a minimum profit to second supplier based on the price actually received by second supplier from its 'jobbers').

13/ Monsanto, 104 S. Ct. at 1470.

14/ This requirement is based on the Supreme Court's recent holding that before a practice is characterized as a resale price restraint, there must be evidence of an agreement between a supplier and its distributors as to resale prices. Monsanto, *supra* note 10, at 1470-71.

distribution program embodying both nonprice and price restrictions, we will analyze the entire program under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies and the-price restraint is merely ancillary to the nonprice restraints. 15/ In Eastern Scientific, the court correctly pointed out that it made no sense to condemn such a program as per se illegal where the program--which allowed dealers to sell outside of assigned territories at a specified price--gave distributors more competitive freedom than they would have enjoyed under a mere nonprice restraint. This approach does not mean we plan to "bootstrap" all resale price maintenance cases into the rule of reason category; rather, consistent with current law, the rule of reason analysis in the Guidelines will apply where nonprice restrictions are at the heart of a distribution program, and price-related restraints are being used to enhance the efficiencies flowing from the nonprice restraints.

After explaining the Department's approach to characterization issues, the Guidelines summarize the most prominent procompetitive and anticompetitive uses for vertical restraints. On the procompetitive side of the ledger, vertical restraints may lower distribution costs, facilitate the entry of new producers into a market, ensure the provision of

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15/ See also Jack Walters & Sons Corp. v. Morton Bldg., 737 F.2d 698, 706-07 (7th Cir. 1984) (Eastern Scientific holding cited approvingly).

pre-sale demonstration and other information services, allow a supplier to protect its investment in services to dealers, and permit firms to allocate risks or costs in an efficient manner. Vertical restraints also can improve product quality and safety and reduce transaction costs in numerous circumstances.

On the anticompetitive side of the ledger, vertical restraints may be used to facilitate collusion among competing suppliers or among competing dealers. The use of restraints to facilitate collusion is unlikely, however, unless concentration is high in a primary market--the level that is the source of market power. Moreover, firms in the secondary market--the market on which restraints are imposed--must account for a large proportion of sales in that market for collusion to be likely. Finally, collusion is unlikely unless entry into the primary market is difficult. If entry into the primary market were easy, new firms would be expected quickly to enter and undercut attempts by established firms to use restraints to hold a cartel together.

Vertical restraints can also be used to exclude rivals from the market in a predatory fashion, by prohibitively raising either their cost of a vital input or their cost of distribution. The essence of anticompetitive exclusion is the attempt by a dominant firm or firms in a 'nonforeclosed market' to prevent rivals from having access to a 'foreclosed market.' As the Guidelines explain, in order for exclusive dealing to facilitate predatory, anticompetitive exclusion, three market conditions normally must hold: (1) the 'nonforeclosed market' must be concentrated and leading firms in the market must use the restraint; (2) the firms subject to the restraint must control a large share of the 'foreclosed market'; and (3) entry into the 'foreclosed market' must be difficult. Harmful exclusion can only take place if it is the dominant firms in the 'nonforeclosed market' that use exclusive dealing. Furthermore, attempts to exclude competitors through exclusive dealing can only work if the 'foreclosed market' is made significantly less accessible to rivals--through the process of 'predatorily purchasing' distribution channels or sources of supply in a market that is hard to enter.

Having described the possible procompetitive and anticompetitive effects of vertical restraints, the Guidelines next turn to a two-step approach for evaluating such restraints. Under the first step, the Department employs a 'market structure screen' in order to eliminate from further consideration those instances of restraints that, in all likelihood, have no anticompetitive effects. In order to apply this screen, the Department first calculates the Vertical Restraints Index--or VRI. The VRI is calculated by determining the market share of each firm in the market that is a party to a contract or other arrangement that contains the nonprice vertical restraint and then summing the values obtained for all firms at the same level of distribution. A high VRI thus reflects high concentration and widespread use of the practice by leading firms. The Department also computes the coverage ratio--the percent of each market involved in the restraint. For example, if ten suppliers with five percent market shares each employ a restraint, the suppliers' level coverage ratio equals 50 percent.

The Department calculates VRIs and coverage ratios for economically meaningful markets--markets in which a firm or firms employing a particular restraint effectively could exercise market power. Under this approach, the Guidelines adopt the market definition principles set forth in the Department's 1984 Merger Guidelines for use in vertical restraints analysis.

Once we have appropriate coverage ratios and VRIs in hand, the Guidelines set up four tests to determine whether a particular nonprice vertical restraint will be examined further by the Department. If the restraint fulfills the conditions set forth in any one of the four tests, we will, without further examination, decide not to challenge it.

Specifically, the use of a nonprice vertical restraint by a particular firm will not be challenged if: (1) the firm employing the restraint has a share of the relevant market of ten percent; (2) the VRI is under 1200 and the coverage ratio is below 60 percent in the same--that is, supplier or dealer--relevant market; (3) the VRI is under 1200 in both relevant markets; or (4) the coverage ratio is below 60 percent in both relevant markets.

The first part of the screen is the most important one. It provides a safe harbor for the use of nonprice vertical restraints by any firm having ten percent or less of the market at its level of distribution. Firms with such small shares do not possess market power individually, 16/ and are unlikely to be ringleaders in any cartel, in any agreement to facilitate a cartel, or in any exclusionary scheme. To the extent this test is widely accepted, we believe that a large number of ill-advised vertical restraints cases will be eliminated. Such a development, we believe, would increase business certainty and encourage efficient distribution practices without harming the competitive process.

The second, third, and fourth tests identify situations in which neither collusion nor anticompetitive exclusion is plausible, because either the primary and/or secondary markets do not meet the minimum structural conditions for a restraint to have anticompetitive effects.

16/ The courts have recognized that firms with very small shares cannot exercise market power. See, e.g., Carlson Machine Tools, Inc. v. American Tool, Inc., 678 F.2d 1253, 1259-60 (5th Cir. 1982)(affirming summary judgment against terminated distributor where manufacturer's share never exceeded 10 percent); Hood v. Tenneco Texas Life Ins. Co., 739 F.2d 1012, 1018 (5th Cir. 1984)(less than 5 percent); JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 698 F.2d 1011, 1017 (9th Cir. 1983)(2.3 percent - 4.2 percent); Ron Tonkin Gran Turismo, Inc. v. Fiat Distributors, Inc., 637 F.2d 1376, 1379 (9th Cir. 1981)(1.87 percent or 5.2 percent); Mutual Fund Investors v. Putnam Management Co., 553 F.2d 620, 627 (9th Cir. 1977)(2 percent or 3 percent).

We believe that the figures of 1200 and 60 percent are good rules of thumb as to the minimum structural requirements. A VRI of 1200 is roughly equivalent to the use of a restraint by one firm with one-third of the market, or by three firms each with 20 percent of the market. A firm with less than one-third of the market is not likely to be able to engage in exclusionary activity. Moreover, restraints are not likely to facilitate collusion where the VRI is below 1200, representing a market configuration of small firms or a few less than dominant firms. Similarly, if less than 60 percent of the market is 'covered,' restraints in all probability cannot further a collusive or an exclusionary scheme. In sum, while our VRI and coverage ratio figures are not written in stone, we think they reasonably portray those market structures in which vertical restraints are not likely to cause a competitive problem. 17/ Moreover, they are consistent with the trend

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17/ In other words, the Guidelines' VRI and coverage ratio thresholds identify structural conditions under which the use of vertical restraints would not plausibly facilitate the exercise of market power. Post-Sylvania courts have recognized that nonprice vertical restraints cannot unreasonably restrain trade--and thus are not illegal--unless the parties employing the restraints possess market power. See, e.g., Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982); Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1202-03 (6th Cir. 1982); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698 (7th Cir. 1984); Oreck v. Whirlpool Corp., 579 F.2d 126, 130 (2d Cir. 1978)(en banc), cert. denied, 439 U.S. 946 (1979), aff'd, 639 F.2d 75 (2d Cir. 1980), cert. denied, 454 U.S. 1083 (1981).

toward judicial adoption of 'a market share analysis of vertical restraints.' 18/

Firms need not get bogged down in intricate calculations every time they apply the Guidelines. In most cases, we believe that it should not be unduly difficult to determine roughly whether a market's structure puts it above or below the step one thresholds. In many cases, simple application of the ten percent test may be enough to determine that a restraint is not troublesome. In other cases, it may be relatively easy to determine whether a market is likely to fall within the Guidelines' VRI and market structure thresholds. In short, we do not believe that the step one standards are 'too hard to apply.' We hope that these standards will become more familiar to and easily applied by antitrust practitioners with repeated application to actual situations.

The Department will apply a 'structured rule of reason' analysis to those vertical restraints that do not pass muster under step one. A step two structured rule of reason analysis is confined to seeking answers to the questions most pertinant to determining the impact of the particular vertical restraint

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18/ Regents of University of California v. ABC, Inc., 747 F.2d 511, 518 (9th Cir. 1984), relying on Continental T.V., Inc. v. GTE Sylvania, Inc., 694 F.2d 1132, 1138-39 (9th Cir. 1982). The Fifth Circuit as well as the Ninth Circuit explicitly has adopted a market share analysis of nonprice vertical restraints. See Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1005-06 (5th Cir.), cert. denied, 454 U.S. 827 (1981).

on competition. If, on balance, the restraint has an anticompetitive effect, the Department will challenge it.

Under the structured rule of reason, the Department first will ask whether it is easy to enter the market for supplying or distributing the product subject to restraint. If entry at both levels is easy, successful anticompetitive collusion and exclusion are not possible, and the restraint under study is lawful. If the Department can identify the primary/nonforeclosed and the secondary/foreclosed market and determine whether the potential concern is collusion or exclusion, entry conditions need to be examined in only one market: the primary market for collusion and the foreclosed market for exclusion.

If, however, entry into the relevant market is difficult, the Department will analyze other factors bearing on the likelihood that the restraint is on balance anticompetitive rather than procompetitive. Such factors include the degree of concentration in the markets under study, whether conditions in these markets are conducive to collusion, the extent to which a restraint is exclusionary, whether there is evidence of an attempt to exclude or collude, whether new or small firms use the restraint, and whether the firms engaging in the restraint can identify credible procompetitive efficiencies from the practice. Only if, on balance, these factors suggest that a vertical practice is anticompetitive, will it be challenged.

After setting forth the two step procedure for evaluating vertical restraints, the Guidelines briefly discuss tying arrangements. Under a tying arrangement, a seller requires that the buyer of a product purchase a second, distinct product as a condition of purchasing the first. The first product is referred to as the "tying" product and the second product is referred to as the "tied" product.

Consistent with current law, the Guidelines indicate that tying should only raise antitrust concern where the firm imposing the tie has "dominant" market power--akin to monopoly power--with respect to the first product to which a second product is tied. Specifically, the Department will not challenge a tying arrangement if the party imposing the tie has a market share of 30 percent or less in the market for the tying product. This presumption can be overcome only by a showing that the tying agreement unreasonably restrained competition in the market for the tied product. This standard is consistent with the guidance recently set forth by the Supreme Court in Jefferson Parish Hospital District No. 2 v. Hyde. 19/

19/ 404 S. Ct. 1551 (1984).

Before closing, I wish to emphasize that we view the development of vertical restraints law as a two way street. We can learn a great deal from the legal and business communities, and we welcome their suggestions and points of view on vertical restraints issues. We will, of course, carefully examine any information private parties may care to provide us concerning the effects of particular vertical restraints. In sum, we view the private sector as our partner in the shaping of a procompetitive, efficient approach to vertical restraints law.

Mr. Chairman, that concludes my prepared remarks. I would be glad to entertain any questions you or other members of the Committee may wish to pose.

U S Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

August 2, 1985

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter responds to your letter of July 18, 1985, to Acting Assistant Attorney General Charles F. Rule. In your letter you enclosed several questions on behalf of Senator Howard M. Metzenbaum concerning the Department of Justice's Vertical Restraints Guidelines. Our answers to your questions are as follows:

> 1. The guidelines require that courts consider any pro-competitive or efficiency justifications made by a defendant. But you also say that "an inability to demonstrate efficiencies should not be interpreted as proof of an anticompetitive explanation for a restraint (efficiencies may be present but the firms may be unable to demonstrate them)." The traditional rule in civil cases, including antitrust cases, is that the defendant's inability to explain potentially illegal conduct is itself evidence that the conduct may be improper. Why should there be special rules of evidence in favor of antitrust defendants who seek to restrain retail competition?

A: The Vertical Restraints Guidelines do not depart from the traditional rule that a defendant's inability to explain potentially illegal conduct is itself evidence that the conduct may be improper. They merely state that such an inability should not be taken as an admission by the defendant that the vertical restraints are anticompetitive.

The statement in the Guidelines to which the question refers is part of a sentence that reads in full:

> While an inability to demonstrate efficiencies should not be interpreted as proof of an anticompetitive explanation for a restraint (efficiencies may be present but the firms may be unable to demonstrate them), an ability to demonstrate efficiencies that withstand scrutiny indicates that an anticompetitive explanation is less plausible than it would be in the absence of an efficiency justification.

Vertical Restraints Guidelines § 4.226

This sentence expresses two related propositions:

> (a) An anticompetitive explanation for a vertical restraint is rendered less plausible by a defendant's ability to demonstrate efficiencies that withstand scrutiny which result from that restraint; an anticompetitive explanation is rendered more plausible by a defendant's inability to identify efficiencies that withstand scrutiny.
>
> (b) An inability to demonstrate efficiencies, while it is evidence that the restraint has an anticompetitive explanation, is insufficient, standing alone, to establish that the correct explanation of the restraint is an anticompetitive one.

"Proof" can mean both "the effect of evidence" and "evidence." 1/ The context in which "proof" is used in the Guidelines, however, shows that the term has the first of these meanings--the effect of evidence.

1/ See Black's Law Dictionary 1093-1094 (5th ed. 1979); Oran's Dictionary of the Law 337 (1983). See also 3 Bouvier's Law Dictionary 2749 (3d Rev. F. Rawle 1914).

If it were otherwise--if 'proof' meant merely 'evidence'--this would amount to creating a conclusive presumption that vertical restraints were efficient. If efficiencies were presumed, there would be no reason to inquire whether a firm could demonstrate efficiencies that withstand scrutiny, nor would there be any basis for saying that an anticompetitive explanation is less plausible in the case of a firm that can demonstrate efficiencies than in the case of a firm that cannot, since efficiencies would be presumed in the latter case. 2/

The explanation for the Department's position--that an inability to demonstrate efficiencies resulting from a vertical restraint is evidence that the restraint is anticompetitive but is insufficient by itself to prove the restraint is anticompetitive--is found in § 3.1 of the Guidelines at footnote 19:

> The reason that a particular restraint is successful in increasing consumer welfare may not be clear until long after the restraint is first used. For that reason, the antitrust laws should not deter business from experimenting with vertical practices that do not pose a substantial anticompetitive risk simply because the practices' procompetitive benefits are unclear.

2. Is there any judicial precedent to support your conclusion?

A: As you state in Question 1, it is the traditional rule in civil cases, including antitrust cases, that defendant's inability to explain potentially illegal conduct is itself evidence that the conduct may be improper. Judicial precedent for this conclusion includes: Northern Pac. Ry. Co. v. United States, 356 U. S. 1, 7-8 (1958); and Computer Statistics, Inc. v. Blair, 418 F. Supp. 1339, 1346 (S. D. Tex 1976).

3. Let us assume that Chrysler has less than 34% of the Cleveland market. Could Chrysler tomorrow designate one dealer as its only dealer in all of Cleveland? *

2/ If 'proof' meant merely 'evidence', then the parenthetical statement 'efficiencies may be present but the firms may be unable to demonstrate them' is far too equivocal and ought to read instead 'efficiencies will always or almost always be present.'

*As to each of these hypotheticals, assume also that no other manufacturer has imposed vertical restraints.

A: Yes. If all Chrysler is doing is unilaterally selecting one dealer for all of Cleveland without any prior agreement, express or implied, with that dealer, its conduct is outside the scope of Section 1 of the Sherman Act. Vertical Restraints Guidelines § 2.5; United States v. Colgate & Co., 250 U.S. 300, 307 (1919); Monsanto Co. v. Spray-Rite Service Corp., 104 S. Ct. 1464, 1469 (1984). If Chrysler designated one dealer as its only dealer in Cleveland, that exclusive distributorship would not violate the Guidelines, since the VRI is less than 1200 and the coverage ratio is below 60 per cent in the supplier market. Vertical Restraints Guidelines § 4.1. See also GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 997 (9th Cir. 1976) aff'd on other grounds, 433 U.S. 36 (1977): "There is a veritable avalanche of precedent to the effect that, absent sufficient evidence of monopolization, a manufacturer may legally grant such an exclusive franchise, even if this effects the elimination of another distributor."

4. Let's assume that Sony has less than 34% of the Columbus market, and tells half the retailers in the entire city that only they can sell Sony televisions but that these retailers can't sell any other brands. Would this be legal? *

* As to each of these hypotheticals, assume also that no other manufacturer has imposed vertical restraints.

A: On the facts of this hypothetical case, the Department would not challenge Sony's exclusive dealing arrangement in the Columbus market since at Sony's market level the VRI is under 1200 and the coverage ratio is less than 60%. Vertical Restraints Guidelines § 4.1.

5. I find one glimmer of hope for discounters in your guidelines, but of course this was not emphasized. As I understand the guidelines, if a product was so desirable and popular that a manufacturer could sustain a 5% price increase for one year, then that product would be considered sufficiently unique that the manufacturer would be a monopolist, and not screened out under your tests. Is this correct?

A: Certainly in some instances if a manufacturer could sustain a price increase of 5 percent for one year, that manufacturer's product would be the product market and he would have a monopoly under the standards of the Guidelines. The appropriate price increase for market delineation will, however, vary from industry to industry so that it cannot always be said that a manufacturer who can sustain a 5 percent price increase for one year is a monopolist.

As a general rule a single manufacturer's brand of product will not be a relevant product market (Vertical Restraints Guidelines § 6.1). Moreover, under the 1984 Merger Guidelines, whose market definition principles are incorporated by reference in the Vertical Restraints Guidelines,

> [i]n attempting to determine objectively the effect of a 'small but significant and nontransitory' increase in price, the Department in most contexts will use a price increase of five percent lasting one year. However, what constitutes a 'small but significant and nontransitory' increase in price will depend on the nature of the industry, and the Department at times may use a price increase that is larger or smaller than five percent.
>
> 1984 Merger Guidelines
> § 2.11 (footnote omitted).

Thus the price increase that is used to define markets is always a 'small but significant and nontransitory' one, but the percentage increase that is 'small but significant' can vary from one product to another.

I trust that these answers are responsive to your questions and will be of assistance to you.

Sincerely,

Phillip D. Brady
Acting Assistant Attorney General

Senator METZENBAUM [presiding]. Our next witness is Prof. Lawrence A. Sullivan, Earl Warren professor of public law, from Boalt Hall School of Law, University of California, Berkeley, CA.

We are happy to have you, Professor Sullivan. You have come a long way. And it is with a little embarrassment that I note that there are four more witnesses, and so I wonder whether you could confine your remarks to 5 to 7 minutes.

STATEMENT OF LAWRENCE A. SULLIVAN, EARL WARREN PROFESSOR OF PUBLIC LAW, BOALT HALL SCHOOL OF LAW, UNIVERSITY OF CALIFORNIA, BERKELEY, CA

Professor SULLIVAN. Yes, I can, Senator. I will try to hit the highlights. I have left my statement with the committee. It is, I think, fairly substantial and fairly complete.

I would start by saying that the most disturbing thing about these guidelines is that they label as vertical and therefore presumably harmless, arrangements that are horizontal and that are not only harmful, but are clearly subject to per se illegality.

In questioning Mr. Rule, sir, you referred to the *GM/Chevy* case. Back in the 1950's, a group of Chevy dealers got together and persuaded the manufacturer, GM, to cut out a discounter. The Supreme Court said explicitly, that conduct was violative of the law.

Mr. Rule now tells us, "Well, I am not so sure." In support of his doubt he cites a group of recent cases that are all horizontal, cases like *BMI.* He says in effect, "We find in those cases some indication that maybe the Supreme Court would act differently today, so therefore, our guidelines can safely ignore the *GM/Chevy* case." That is an example of the kind of thinking that is involved in these guidelines. To me, frankly, it is disturbing.

Mr. Rule also testified that *GM/Chevy* is the only case that the guidelines are inconsistent with. That is not true. In the 1970's, TOPCO and Sealey dealers agreed among themselves, in the one case, to divide territories, and in the other, to divide territories and to fix prices.

In both cases, the Supreme Court held the conduct to be per se unlawful. These guidelines in paragraph 2.1 would lead one to conclude that those two arrangements, and others like them, are harmless, and that they ought not to be treated like other horizontal agreements, that they ought to be treated as vertical because only one brand is involved. In sum, the guidelines state that such arrangements are not per se unlawful, but are to be subject to the guidelines screens—screens which are well-calculated to screen out as harmless a great many of these horizontal restraints.

Even *Monsanto,* which was decided last term, is inconsistent with these guidelines. *Monsanto* responded to dealer blandishments to enforce resale price maintenance against its pesticide dealers. The Supreme Court last term said that was per se unlawful conduct. But *Monsanto,* too, was a one-brand case. *Monsanto* would not have passed the guidelines screening tests. Under these guidelines the *Monsanto* conduct would have been perfectly lawful.

Mr. Rule also talked about looking for RPM cases to bring, and finding it difficult. The question that occurs to me is: Where was the Department in the *Monsanto* case? There was a perfectly clear, solid case of resale price maintenance. But it was the private plaintiff that brought the case. The Department of Justice was kicking and screaming in the other direction, trying to stifle that litigation, trying to persuade the Court that the RPM conduct should not be unlawful.

These guidelines are in the spirit, if not in precise terms, consistent with the position that the Department took in the *Monsanto* case. They contain general language amounting to a grudging consent that resale price maintenance is unlawful. But if you apply the guideline particulars, since resale price maintenance cases are almost always single-brand cases—you rarely find, an "explicit conspiracy" among several manufacturers to apply resale price maintenance—RPM arrangements will almost always escape under paragraph 2.1 of these guidelines.

There has already been reference by Senator Rudman to the "explicit agreement" requirement. I suppose if you are looking for signed and sealed resale price maintenance agreements, you are not going to find very many, and so it is not surprising that you will not find very many cases.

When you go back and compare what happened in prior administrations, you have got to remember one thing. In prior administrations, in the Carter years, for example, there were not very many of these cases brought by the Antitrust Division, because the Antitrust Division knew it could rely on the private bar to bring them. At that time the Division was not trying to get in the way of the private bar, either by filing friend of the court briefs in opposition to private enforcement, or by filing guidelines which took the position in essence that this kind of conduct was unlawful.

So, antitrust enforcement comes not only from the Division, and the Division should be selective about what it does, but antitrust enforcement also comes from the private bar, and the Division ought to be helpful and supportive of that, rather than resistant to it, as this Division has been.

The guidelines are also inconsistent with *GTE Sylvania*, the very case that they cite most frequently for support. In paragraph 2.5, the guidelines develop this new category of "always lawful" restraints.

Well, Senator Metzenbaum, in your questions to Mr. Rule, you anticipated a lot that I would have said. *GTE Sylvania* itself told us that, far from being always lawful, location clauses are subject to the rule of reason.

The *Ebeling* case tells us that "passover arrangements" are subject to the rule of reason, and indeed, that the one involved there was unlawful. Each of the other passover cases that the guidelines cite in paragraphs 2–5 were cases where the court said, "You apply the rule of reason; you scrutinize these arrangements to see whether on balance they are reasonble or not."

Senator SPECTER. Professor Sullivan, may I interrupt you for a moment?

Professor SULLIVAN. Surely, Senator Specter.

Senator SPECTER. We have the law, as established by the statutes and the court interpretations, and now we have guidelines promulgated by the Department of Justice which will make what some believe to be major modifications in existing law. And now, we are considering "sense of the Congress" resolutions, one having been introduced in the House, and one likely to be introduced in the Senate, stressing the sense of the Senate and the sense of the House, if they are passed, for the courts to disregard these Department of Justice guidelines.

What does all this mean? What effect, in your legal opinion, do the guidelines have in terms of influencing courts on applying existing law, and what impact is there on a "sense of the Senate" resolution in disapproving guidelines? Isn't this all an exercise in shadowboxing?

Professor SULLIVAN. I do not think it would be an exercise in shadowboxing, Senator. It is hard to say what the effect of these guidelines would be on the courts. We have some experience with guidelines before, but the earlier guidelines—certainly, the Turner merger guidelines, certainly,the Schenefield and Litvak guidelines about international operations—those were guidelines that were honestly attempting to state what the governing law was. They were a serious effort to look at existing case law and express in general what the norms were.

Senator SPECTER. Well, where the guidelines seek to amplify or to put some flesh on the bones of existing statutes and decisions but are consistent with those, then they may have some weight—may or may not—but if the guidelines are at variance with Supreme Court decisions, that is your basic position?

Professor SULLIVAN. That is my position, and——

Senator SPECTER. So what is the importance of the guidelines?

Professor SULLIVAN. Quite frankly, Senator, in terms of affecting courts, it is hard to say what the effect of these guidelines would be. I would hope that the district judge in Fresno, for example, would not be persuaded that these guidelines were restatements of the law. But I do not have complete confidence in that. There are a lot of district judges sitting throughout the country who do not often get antitrust cases, who are not highly familiar with antitrust concepts. If they get a document presented to them by the defense counsel which carries the imprimatur of the Antitrust Division, certainly, that may have some influence.

Senator SPECTER. It strikes me as not being weighty at all, and not having any real substance.

Professor SULLIVAN. I would hope that you are right. But next, Senator, another aspect of these guidelines is what they do to conduct. We are not always in a courtroom before a district court judge. We are sometimes in the board room. We are sometimes in the office of inside counsel.

These guidelines—I think we can see already that the whole range of expressions by this administration of its disinterest in these cases, and of its disdain for good deal of existing antitrust law—a good deal of that has already led to considerably more aggressive conduct by firms in the area of vertical restraints.

Senator SPECTER. Well, I can see the guidelines being a good defense to a criminal prosecution, but there is not going to be one of those, anyway.

Senator METZENBAUM. I would like to point out to my colleague that before you arrived, Mr. Rule indicated that they would intend to cite the guidelines in amicus briefs. And so, you find one department citing its own guidelines, and somehow, that becoming a weighty tome that can be used in a district court case. And as the Professor points out, that judge may not just appreciate how significant or insignificant those guidelines are.

Senator SPECTER. When someone quotes himself, Senator Metzenbaum, it may not add a whole lot.

Senator METZENBAUM. Well, but I am not sure that the district court realizes the implications of that, and I am not sure they are quite as smart as that. And it sounds as if these are guidelines of a whole department. They have been made by that outfit in Washington called the Antitrust Department. So when a case comes up in some small community, they very well may have some value. As you very appropriately point out, they really shouldn't, but they may. And that is the reason, I think, that some of us have such concern about them.

Senator SPECTER. Well, they may have some effect. I just wanted to explore that with Professor Sullivan in terms of his view of their impact. We have been on this subject for a long while in this committee, and sometimes when we enact "sense of the Senate" resolutions, I wonder why we do it because it does not have the force of law. It is a statement of our feeling on the subject.

I appreciate your comments, Professor.

Professor SULLIVAN. There are a number of other aspects in which these guidelines are inconsistent with law. It seems to me that they are inconsistent with *GTE Sylvania* in terms of what the rule of reason contains and what the rule of reason means when it is applicable.

Under these guidelines, the rule of reason would be applied to territorial and customer restraints. *GTE Sylvania* in those situations called for a balancing, a comparison of intrabrand injury to interbrand benefit. These guidelines say, in effect, intrabrand competition is irrelevant. They would make even the most airtight territorial restraints unlawful only in situations where they were part of a dealer, multibrand cartel, or a manufacturer multibrand cartel.

Senator METZENBAUM. Professor Sullivan, I am going to have to leave at about 10 to 12, because I promised to tape a TV show with Senator Hatch. And I am wondering whether, if the chairman has no further questions, if you would consider it an impertinence if we just submitted our questions to you in writing.

Professor SULLIVAN. Not at all, Senator.

Senator METZENBAUM. Mr. Chairman, unless you have any further questions, I think Professor Sullivan's testimony is concluded, and we can get to the panel.

The CHAIRMAN. Professor Sullivan, I want to thank you very much for your appearance here and the testimony you have given on this occasion, and we appreciate your presence.

Professor SULLIVAN. Thank you, Senator.

[Prepared statement and response to written questions follows:]

BEFORE

UNITED STATES SENATE

COMMITTEE ON THE JUDICIARY

WASHINGTON, D.C. 20515

STATEMENT OF:

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HEARINGS ON:

THE U.S. DEPARTMENT OF JUSTICE

1985 VERTICAL RESTRAINTS GUIDELINES

JULY 16, 1985

Introduction

I am pleased to have been invited to give my views on the matters before this Committee because the issues involved are important. The Vertical Restraints Guidelines are being presented by the Antitrust Division as restatements of existing law, as guides to efficiency, and as a statement of enforcement policy. But rather than reflecting existing law, they distort it. Nor are they efficiency producing; they do as much to inhibit efficiency as to encourage it. And as statements of enforcement intention they are in one sense superfluous -- because everyone has known for years that the Antitrust Division largely ignores vertical restraints -- and in another sense confusing -- because they mislead people in the marketplace about the legality of restraints that they may be considering.

To be blunt, the 1985 Vertical Restraints Guidelines move implacably in the wrong direction. They show a blatant disregard for important Supreme Court cases, and for clearly expressed Congressional intent. Although superfluous as statements of what enforcement the Division will do, they have the obvious purpose of influencing the outcome of private cases and the probable effect of reducing the likelihood that such cases will be brought, even when existing law supports them.

Territorial 'Balancing' and RPM

For one thing, these guidelines would allow manufacturers to impose even air tight territorial restraints on downstream firms in virtually any situation where there is an indication of interbrand competition at the manufacturer level. They thus ignore the teaching of Continental T.V., Inc. v. GTE Sylvania 433 U.S. 36(1977) that the rule of reason requires a balancing of any claimed benefit to interbrand competition against any apparent harm to an intrabrand competition. For another, the Guidelines impinge on the per se rule against resale price maintenance by characterizing conduct as unilateral or as involving some other (non-price) restraint even when, in fact, concerted conduct with the purpose and effect of stifling price competition is involved. In this respect they not only reject or ignore an unbroken string of Supreme Court precedents running from Dr. Miles in 1911 through Monsanto in 1983, they also ignore the intent of Congress as expressed through the Consumer Goods Pricing Act of 1975 which repealed the McGuire and Miller-Tydings Acts.

Dealer Cartelization

Third, these new guidelines characterize as vertical restraints some conduct that is plainly horizontal in origin and therefore subject to the strict per se analysis that applies to manifest efforts to cartelize. Indeed, this aspect of the guidelines seems to sanction even the most aggressive and explicit cartelization by dealers who concertedly induce a manufacturer to drive a price cutter out of the market; so long as the dealers act only against one manufacturer's brand, the guidelines imply that they are doing no harm to competition.

This startling position ignores (or attempts by administrative action to "overrule") the Supreme Court decisions in United States v. G.M., 384 U.S. 127 (1966), as well as the Topco and Sealey cases.

In all of these respects the guidelines are inconsistent with existing law and are also demonstrably unsound as a matter of policy. They threaten to impose significant additional costs on consumers, as well as to reduce the range of consumer choice and the market mobility both of manufacturers (who may now suffer the dictates of a dealer cartel) and of dealers (who may now be constrained by manufacturers not only as to territory, but also as to price.)

Radical Revisionism

Is there any justification for such radical revisionism? The approach to vertical antitrust issues which the guidelines embody is based upon a single, narrow, theoretical conception -- the Chicago "free rider" theory. This theory uses a supplier decision about supplier welfare as a surrogate for consumer welfare. The theoretical claim is that informed, rational decisions by suppliers about virtually every aspect of the downstream marketing process will yield the ideal mix of price, promotion, and service at the downstream level -- the mix that will maximize consumer welfare.

The contention is that the manufacturer will be unable to get the promotion needed, or the point of sale service needed, without access to restraints like airtight territorial division. (Indeed, the Guidelines even validate control of prices by any device short of explicit contractual commitments by downstream firms.) These needs arise because of the "free rider." Dealer "A" will not provide the promotion or amenity the manufacturer wants if dealer "B"m who does not provide them, can share the benefit.

In passing the Sherman Act, Congress had in mind several goals associated with a free market.[1] But even limiting consideration to micro-theory and taking efficiency as the only goal, this extreme version of free-rider theory falls short. Well known micro-theorists, including distinguished Chicagoans, find it unacceptable. For example, Professor Ward S. Bowman, Jr. (with credentials as a rigorous micro-theorist of Chicago persuasion) takes quite a different view.[2] Using Chicago's rationality, perfect information and profit maximizing assumptions to argue against legalizing rpm, Bowman shows that resale prices: cannot be maintained unless the product enjoys some degree of monopoly power;[3] probably cannot be maintained without horizontal cooperation;[4] and will be a rational and effective device for a supplier only "where there is a substantial departure from competitive standards both on the producing or manufacturing level <u>and</u> on the reselling

1.<u>Northern Pacific Railway Co. v. United States</u>, 351 U.S.1, 4-5 (1958); Lande, <u>Wealth Transfers as the Original anu Primary Concern of Antiturst: theEfficiency Interpretation Challenged</u>, 34 Hast. L.J. 65 (1982).

2.Bowman, <u>Resale Price Maintenance--A Monopoly Problem</u>, 25 J. of Bus. 141 (1952).
3.<u>Id</u>. at 145.
4.<u>Id</u>. 145 n. 15.

level...."[5] In sum, rpm signifies the existence and exploitation of bilateral market power, shared by the supplier and dealers.

Thus, Chicago theory gives two alternative explanations for rpm: the Bork-Posner "market failure" explanation, and the Bowman "market power" explanation.[6] Though the Bork-Posner thesis has been better publicized to the judiciary, rigorous theoretical commentary strongly reinforces the Bowman view.[7] The centerist position is perhaps that discussed by Professor Caves.[8] Neither the shared power nor market failure explanation should be reified. Each suggests a possibility, a tendency, perhaps a partial truth. Even though supplier-dealer shared market power is involved in supplier-initiated rpm, the supplier may sometimes by acting to further differentiate its product. However, differentiation is not an unmixed good. It is a way to disaggregate markets -- to make the demand curve steeper, to allow the supplier to price above the competitive level.[9] The Caves paper also emphasizes the vast array of devices other than rpm that are available to a supplier seeking to differentiate,[10] and shows that in many actual markets rpm, if used instead of less restrictive means, can severely injure competition.[11]

In their debate with Bork, Professors Gould and Yamey point

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5. *Id.* at 148.
6. Caves, *Vertical Restraints as Integration by Contract: Evidence and Policy Implications* (Harv. Inst. of Econ. Research, Discussion Paper No. 754, FTC, April 1980).
7. Holahan, *A Theoretical Analysis of Resale Price Maintenance*, 21 J. of Econ.Theory 441 (1979).
8. Caves, *supra* n. 41.
9. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 Harv. L. Rec. 1419 (1968).
10. Caves, *supra* n. 41.
11. *Id.*

out yet another crucial defect in free-rider theory.[12] They do not set themselves against Bork's analytical style but insist on pressing its deductive logic as far as it will go. Doing this, they show that when rpm is used by a supplier to differentiate its product and to alter and change consumer taste, there is no theoretical yardstick with which micro-theorists can measure effects on consumer welfare.[13] When one turns to industrial organization economists (who trade off some of the "rigor" of Chicago theory for a closer touch with empirical reality), support for rpm virtually disappears.[14]

Recently, other distinguished economists have shown that the

12.Gould and Yamey, Professor Bork on Vertical Price Fixing, 76 Yale L. J. 722 (1967); Gould and Yamey, Professor Bork on Vertical Price Fixing: A Rejoinder, 77 Yale L. J. 936 (1968). The Bork articles, with which these papers take issue, are those cited in note 35. Professor Yamey also discusses rpm in Yamey, "Introduction: The Main Economic Issues" in Yamey (ed.), Resale Price Maintenance 3-21 (1966).

13.Micro-theory is static theory. Its ultimate guide to welfare is what consumers at a given time prefer. When suppliers make efforts -- even wholly legitimate ones -- to change consumers' tastes, there is no rational way to determine whether the end state is preferable to the beginning state; the yardstick has been altered along with the goods being measured. The Bork-Posner position thus depends on what is ultimately a wholly arbitrary identification between supplier profit-maximizing conduct and consumer welfare. It relies on "the proposition that promotional activities which are profitable to the entrepreneur necessarily improve the allocation of resources," a proposition that "has not, and indeed probably cannot, be derived from standard welfare economics." Since "Bork relies [as does Posner] on standard welfare economics" he "has not demonstrated the validity of his proposition." Id. at 77 Yale L. J. 938-39. This difficulty is amplified, of course, when suppliers attempt to change consumer preferences by convincing consumers that a branded product is significantly different from other products when in actuality it is substantially identical with them, or attempt in other ways to mislead consumers about product attributes.

14.Major industrial organization and antitrust scholars have supported the per se ban on rpm. See, e.g., 3 Areeda & Turner, Antitrust Law § 828d (1978).

Bork-Posner theory focuses only on the possible welfare gains from vertical restraints and totally ignores the equally likely losses (which, intuitively, are likely to be larger). If, for example, either rpm or a vertical territorial restraint is used by a manufacturer to encourage dealers to provide more information, this may have both positive and negative welfare effects. It may increase the welfare of "marginal" consumers -- those who learn about the product only through the incremental promotion. This is the effect on which Bork and Posner focus. But the restraint will also increase the price to all consumers sufficiently to cover the cost of the additional promotion. For the consumers who knew about the product without the additional promotion, that price increase is a net loss -- a welfare loss which may overwhelm the gain by marginal consumers, but a loss that Bork and Posner ignore.[15]

With no convincing theoretical justification, free rider purists proceed as though all value were added at the manufacturing level, and that all innovation takes place there. In this conception, wholesalers and retailers are merely a pipeline. They deliver the product, and they all ought to do it in the same way, the way the manufacturer identifies as best. He decides on the ideal product, promotion, service mix, not only at his own level, but also at every downstream level; he then uses whatever mix of vertical restraints (exluding only blatant,

15.See Comanor and Kirkwood, Resale Price Maintenance and Antitrust Policy, 3 Contemp. Pol. Issues 9 (1985); Scherer, The Economics of Vertical Restraints, 52 Antitrust L.J. 687 (1983); Spence, Monopoly, Quality and Regulation, 6 Bell J. of Econ. 417 (1976).

unvarnished, pre-agreed resale price fixing) to see to it that downstream firms conform to his vision.

Dealer Level Differentiation

In fact, downstream firms -- for example, retailers -- do not merely "deliver" the products of their suppliers. Retailers make investments and add value themselves. They may vary in locational (and thus time) convenience, in the range of merchandise they keep in stock, in the kinds of information and personal service they offer, and in atmosphere and style. Because they add value in these ways, they use their suppliers' products as an "input," much as, say, a manufacturer of appliances uses machine parts as an "input." Different retailers combine a particular supplier's product with other elements to provide different, and alternative outputs, just as different appliance manufacturers differentiate their end products, though many of the inputs are the same. At the downstream as well as at the manufacturer level, these differences increase the range of options open to consumers.

Innovation and Stereotyping

Moreover, innovation can occur downstream as well as at the manufacturing level. There have been numerous innovations in marketing, just as in production: the department store; the supermarket; the mail-order firm; the discount store; the boutique; and others come to mind. All have added to the variety and range of choice open to consumers. Many have served to reduce the cost of getting merchanidse to the consumer. Each of these developments could have been slowed down or even stifled if a full range of vertical restraints had been effectively utilized for that purpose by manufacturers who saw downstream firms as performing a stereotyped function in a stereotypical way.

The Most Distorting Restraint

Most Chicago theorists do not differentiate between price and non-price vertical restraints. They use free rider analysis as a justification for restraints of all kinds. Thus, it is not surprising that the Division, having accepted the Chicago analysis, has tried through the guidelines to impose it as widely as possible, and to errode the *per se* rule against price fixing, now that in *Monsanto* the Supreme Court has rejected the Division's straight-forward effort to induce the Court to overrule that *per se* rule.

Actually there are significant distinctions between price and non-price vertical restraints, distinctions that ought to lead a vigorous analyst to support *per se* condemnation of vertical price fixing even if non-price vertical restraints were thought justified by free rider theory. For one thing, a territorial or customer (or comparably rigid location restraint) can foreclose all competition from outside the territory; these restraints can, quite literally, keep the free rider out. A vertical price restraint, by contrast, does not keep competitors from entering each other's areas (although it may reduce somewhat the incentive to do so). Thus, territorial (and like) restraints are not only less restrictive alternatives than price restraints with which to attack any free rider problem (real or imagined), they are also far more effective alternatives. They are well calculated to keep the free rider out. Price restraints are not.

Market Share and Differentiation

Even more importantly, vertical price restraints do even more serious injury to competition than do vertical territorial and similar restraints. The competitively ideal price -- indeed, the ideal that is consistently embraced by Chicago theorists, including Bork and Posner themselves -- is the price equal to marginal cost. Territorial and like restraints will sometimes (perhaps often) result in supra-competitive prices -- prices higher than marginal costs -- because, by reducing intrabrand competition, they will enhance dealer market power. Certainly air tight restraints will tend to do this. But all such restraints will not inevitably lead to that result. They will yield power and supra-competitive prices if the particular brand represents a large share of the market. They will also do so, even despite a seemingly small market share, if the particular brand is very effectively differentiated, so that many buyers are loyal to it and will buy it even on an increase in its price relative to other brands. But if neither of these conditions prevail -- if the brand does not have a large market share, and interbrand competition is intense -- territorial and like restraints may not yield supra-competitive pricing. Competitive, marginal cost pricing, may prevail despite the restraint.

Retailer Cost Differences

In the case of vertical price fixing, by contrast, competitive interactions are inevitably distorted, even in those instances where the manufacturer has a relatively small share and buyer loyalty to the brand is not particularly strong. The reason is this. Retailers of the brand do not all experience the same costs. If they vary in their product-service-information and amenity mixes (for example, if they include department stores, local boutiques, and low service "warehouse" stores) thier cost differences will be obvious. But even if retail outlets are highly standardized -- indeed, even if service, inventory, and information are completely standardized as in a franchise operation -- retailer costs will differ, and can differ materially at different locations. Two outlets at different locations can be in distinctly different markets for various inputs. Thus, they may be in different real estate markets -- some in high rent urban districts, some in suburbs, some in rural places. And at different locations they may also be in different labor markets. For example, you pay more to a sales clerk in Washington, D.C., than in rural Virginia.

Geared to the Least Efficient

Given these inevitable differences in retailer costs, it is equally inevitable that any manufacturer imposing a single resale price on all retailers will preclude marginal cost pricing by all retailers save those who happen to experience marginal costs equal to the manufacturer-imposed price. On the face of the matter, the manufacturer's price must be high enough to allow even the highest cost retailers staying in the market to cover their costs. Thus, lower cost retailers will be forced, like it or not, into supra-competitive pricing.

Price - Service Distortion

True, this condition may not be the stable one. But the condition achieved by adjustments is no more consistent with effective competition. Those retailers experiencing supra-competitive returns may do what monopolists often do -- they may engage in what economists call "rent chasing" activities. In order to increase sales at the supra-competitive prices they may spend more in promotion, amenity or services, thus pushing their costs somewhat closer to the imposed price. The one thing they cannot do, is what they would do if able to follow the competitive ideal -- namely, decide for themselves whether and to what extent to lower price and whether and to what extent to increase service in their effort to effectively compete. The result, rather, is the very condition that Chicago theorists so consistently criticized when they observed it in the pre-deregulation airline industry: The mix of price and service competition is distorted by an imposed price. Prices are higher and promotional expenditures are higher than either would be if free competition were permitted to prevail. Consumers get more service or amenity than many would choose, if given free choice, and to get it they are forced to pay a higher price.

Surviving, Even Thriving, Side-By-Side

The free rider is not entirely a myth. There is, of course, in some marketing situations a real free rider problem. But there is virtually no reason to suppose that this problem is nearly so serious or widespread as the guidelines suppose, nor that it needs to be dealt with through Draconian responses which, in effect, could convert a major segment of the economy intc a mere pipeline. As can be observed in literally any urban area, various types of outlets -- specialty stores, department stores, mail order stores, back-street discount operations -- do exist and thrive in virtually every urban market. They exist successfully and side by side for a wide range of products, from food and soft goods to appliances and even computers. It is not essential that every dealer do everything the same way, and that each receive protection from the others, to assure that some dealers will provide a high degree of information, promotion, service and amenity. Many retailers choose this course and attract consumers who want and are willing to pay for this level of service even though other retailers offer lower prices and less service or information.

Less Restrictive Alternatives

Moreover, there are ways short of airtight territorial restraints (and certainly short of the price restraints the guidelines seem to sanction) to deal with the free rider problem when it is encountered in circumstances that do make it serious. Many point-of-sale activities sought by the manufacturer -- for example, warranty service or other product service -- can be individually priced, rather than tied to product sales. The free-rider is then foreclosed by the pricing system. Others -- for example, point of sale promotion or advertising -- can be paid for in whole or part by the manufacturer through "co-op" programs or the like. Others -- full line displays, for example -- can be mandated by the manufacturer as a condition for continued dealing without imposing other vertical restraints that may reduce price competition or product or service variety competition in other respects. And if some dealer separation is also needed, it need not be airtight. Primary responsibility, promotion payment pass overs, or other such devices, reasonably calculated to meet the specific problem can be used. Such a "less restrictive alternative" analysis is also part of the conventional rule of reason, and is thus implied by what the Court said in GTE Sylvania; but the guidelines ignored it.

Mislabeling and Dealer Duress

Indeed, ignoring case law which makes each "less restrictive alternative" device itself a subject to rule of reason evaluation, the guidelines create a brand new "per se lawful" category. They label some devices, including location clauses, and pass throughs, as always benign and never subject to challenge. This too ignores settled law and common sense. It should be obvious that a well crafted location clause can be as airtight as a territorial division. If A can sell TV sets only from downtown Washington and B can sell them only form downtown Baltimore, A and B will not compete with each other any more than would firms with a Baltimore territory and a Washington territory. In such circumstances, the legality of the location clause should be evaluated as would a territorial restraint -- by balancing harms and benefits under the rule of reason. Indeed, the Sylvania case, in which the Court held the rule of reason to apply, was itself a location clause case, not a territorial restraint case.

Insofar as the guidelines sanction single brand dealer cartelization that can force a manufacturer to award airtight territories, or even to drive out price cutters, the guidelines cannot even claim the sanction of the Chicago free rider rationale. That rationale pre-supposes a unilateral decision made by a manufacturer not acting under duress. Free rider theory, if accepted uncritically, may countenance efforts by manufacturers to get market information from individual dealers, but even free rider theory presupposes that, in the end, the manufacturer makes his own calculation of his own profit maximizing course.

Conclusion

From this Administration, Americans can expect a "conservative" antitrust policy. Indeed, they deserve such a policy, for they have by their votes indicated, if even in a general way, a preference for a conservative approach to economic issues.

But there are various styles of conservatism. That manifested by the current Antitrust Division can be called "radical conservatism," for it presses vigorously for change. It uses simple, static, theoretical models as guides to efficiency. It seeks to change existing law and institutions whenever it thinks that these are out of accord with the models.

There is another conservative approach that might be called "traditional conservatism." It recognizes that both the economy and sensible governance are complex. It takes an organic view of affairs, recognizing, in Pauline terms, that we are all one body, each with a unique contribution to make -- consumers and producers; large firms and small; upstream manufacturers and downstream distributors; stockholders and managers. Balance and judgment are needed to keep the system functioning effectively. One should not overreact either to a theoretical argument, or a plea from any one sector. Moreover, the past -- if you will, existing law -- has a canonical value. Even courts ought not to feel free to change established rules every time a different economic theory comes into vogue. If existing law is to be changed, it ought to be changed by Congress (or in appropriate respects, by the Supreme Court) in response to realistic and convincing arguments -- arguments that identify real problems adversely affecting real people. The governing dictum of this style of conservatism - the one to which I would urge the Committee to subscribe -- is this: "If it's not broken, don't fix it."

In the performance of its oversight function, this Committee ought to make clear to the Division as well as to the public that the Vertical Restraints Guidelines exceed the bounds of prosecutorial discretion and are inconsistent with law.

ANSWERS BY PROF. LAWRENCE A. SULLIVAN
TO QUESTIONS SUBMITTED BY SENATOR METZENBAUM

1. In your opinion, Professor, do the guidelines accurately state the law by limiting the per se rule against resale price maintenance only to explicit agreements about specific prices?

A: No, Senator, they do not. Supreme Court cases like United States v. Park, Davis & Co., Simpson v. Union Oil Co., and Albrecht v. the Hearald Co., all show the inaccuracy of the guidelines' implication that only explicit agreements about specific prices violate the Dr. Miles rule. So do many lower court cases, like Geo. W. Warner & Co. v. Black and Decker, a Second Circuit case. In that much-cited case the court said that any vertically imposed arrangement limiting resale prices other than a Doricly simple refusal to deal would violate the law.

2. Are the guidelines correct in concluding that restraints imposed because of an agreement among competing retailers are not per se illegal if the retailers only sell one brand?

A: The guidelines are patently wrong. They label as vertical even blatantly horizontal agreements to fix prices, or divide territories merely because only one brand is involved. GM/Chevy, GTE Sylvania, Topco, Sealy and Monsanto all show that horizontal price, territorial or customer arrangements are per se unlawful, whether one or more brands are covered by the conspiracy. Indeed, every one of those cases was a single brand case. The guidelines speak as though those cases did not exist.

3. Are location clauses and profit passover arrangements always legal, as the Justice Department claims?

A: Clearly not. As the cases cited in the guidelines themselves establish, such arrangements are subject to the rule of reason. Under the norms announced in GTE Sylvania, the legality of such arrangements is determined by contrasting the harm they do to intrabrand competition with any benefit that they may yield for interbrand competition.

4. Is there any legal basis for the guidelines' claim that no adverse inference should be taken from the fact that a defendant can't come up with a legitimate justification for a restraint?

A: Not as a matter of law. Indeed, not even as a matter of Chicago School economics. The theoretical assumption is that traders are doing things to maximize profits. If the sponsor of a trade restraint cannot offer a plausible, innocent explanation the normal inference might well be that there is a non-innocent motive.

5. The Department claims these guidelines are "simple" and "easy to use." Do you agree?

A: If you take them seriously as a means for discriminating between lawful and unlawful restraints they are certainly not simple. I have never seen a more complex web of screens than those specified here. Few traders would possess or have low-cost access to the data needed to complete the analysis. In another sense, however, the guidelines are simple and clear. The overriding message, surely, is that the Department does not like the existing law of vertical restraint and intends to do as little to enforce it as we can get away with. That message comes through clearly enough.

6. Do consumers benefit from intrabrand retail competition? Please explain.

A: Of course they do. Competition tends both to reduce price and to spur cost-reducing efficiencies. It has this effect whether the competition is from a different brand or from the same brand. It is true that some same-brand restraints can in some circumstances have some affirmative effects on interbrand competition. For example, primary responsibility clauses, location causes, or passover arrangements might be used by a new entrant or a weak brand to encourage point of sale promotion or service. But even when a benefit of that kind is present, there is also a cost. The restraint is intended to reduce intrabrand competition, thus enabling the dealer to charge a higher price. The notion is that interbrand competition will preclude the dealer from pocketing a monopoly return; he will be forced by interbrand competition to spend the extra return on promotion or service. The welfare of consumers who would not otherwise have known about the product, or who had need for the additional service, will thus be increased. But the cost is there too. All consumers pay the new, higher price that the restraint supports, including those that knew about the product even before the restraint, and those who do not need the additional service.

In short, any vertical restraint, by reducing intrabrand competition, is likely to cause a price increase, and to reduce the range of price-service-amenity options open to consumers. This will always involve a welfare loss to some consumers. In some instances, though not in all, there will be a fully or partially off-setting welfare gain.

7. Chicago school theorists claim that a manufacturer always will pick the best way to distribute its product. Do you agree?

A: The manufacturer will always be motivated to pick the way that is likely to maximize manufacturer returns. If that is what the "best way" means, there is certainly something to the Chicago view. Of course the manufacturer isn't always right about what is best even for the manufacturer. Recent economic studies done by outside consultants for the FTC show that the use of vertical restraints by manufacturers sometimes hurts the manufacturer as well as the consumer.

But it is more important to recognize that even when the restraint enhances the return to the manufacturer, that does not mean that the manufacturer is distributing the product in the way that is "best" for consumers. Manufacturer welfare is not a reliable surrogate for consumer welfare. Some Chicago theorists, like Bowman, have recognized this. Others, like Posner and Bork, have not. As my answer to the prior question shows, a vertical restraint always hurts those consumers who do not need (and would, if given the choice, not have paid for) the additional information, additional service or additional amenity supported by the higher prices facilitated by the restraint. The restraint is a benefit only to those consumers who, if given the choice, would have preferred to pay the higher price in order to receive the additional service, information or amenity. Indeed, the restraint benefits these consumers only if, but for the restraint, no dealer would have offered the higher price, higher service, information, or amenity option. If the market would have given a reasonable range of such options even without the restraint, there are consumers whose welfare is impaired, but none whose welfare is improved. In sum, the manufacturer may choose the method of distribution best for him, but not best for consumers.

8. I have also introduced legislation today to clarify the Supreme Courts <u>Monsanto</u> decision concerning providing vertical price fixing conspiracies. Do you believe such clarifying legislation is desirable?

A: Yes, I do. I have not seen a copy of the bill you are introducing, Senator, so I cannot comment on it in particular. But I can comment on the problem generally.

Monsanto leaves in considerable doubt what kind of evidence is needed to establish a vertical price fixing conspiracy. When two or more dealers complain of price cutting by another and the supplier, in response, imposes discipline on the price cutter, there is concerted action -- a "combination" or "conspiracy" in a literal sense. Monsanto seems to make the legality of that conspiracy turn, in part, upon whether the supplier acted from its own motives, -- that is, from motives different from those of the complaining dealers -- or upon whether the supplier felt coerced. To make legality turn on such matters is to add to the law a new complexity which will inevitably reduce the potency of the law to inhibit economically harmful vertical restraints. In Dr. Miles itself, the supplier had its own independent reasons for wanting RPM. Before Monsanto that fact was never supposed to blunt the per se rule .

9. Is there any policy reason why discounters should have a special burden of proof concerning conspiracies?

A: I see none.

10 What effect will the Monsanto decision, if uncorrected, have on the ability of discounters to continue their pro-consumer practices?

A: Monsanto will tend to make it easier for other dealers to gang up on a price-cutting competitor and to elicit from the supplier discipline or even termination as a sanction for price cutting. In terms of consumer welfare this is very unfortunate.

The CHAIRMAN. We will now go to the panel.

Mr. Monroe Milstein, chairman of the board, Burlington Coat Factory, New York; Stephen Jelin, president and chief executive officer, Prange Way Co., Green Bay, WI; Dr. Robert Huntley, president of Best Products Co., Richmond, VA, and A. Robert Stevenson, vice president, K-mart Corp., Troy, MI.

We are glad to have you gentlemen here.

Senator METZENBAUM. Mr. Chairman, could I respectfully suggest that you hold each of these witnesses, who have come long distances—and I do want to know the thrust of their testimony—but I wonder if you could ask them if they would cooperate to limiting themselves to 5 minutes each.

Would that be fair, gentlemen?

The CHAIRMAN. We would like for you to just give us the thrust. I think you can tell us in 5 minutes why you are here; in other words, what do you object to here, and your point of view. And if you have written statements, we can put the whole statement in the record.

On account of time restraints, we have got to stop at 12 o'clock anyway, and it is 11:32 now.

We will be glad to hear from Mr. Milstein first.

STATEMENT OF A PANEL, INCLUDING: MONROE MILSTEIN, CHAIRMAN OF THE BOARD AND PRESIDENT, BURLINGTON COAT FACTORIES, INC., NEW YORK, N.Y., ON BEHALF OF THE ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC., WASHINGTON, DC; STEPHEN J. JELIN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PRANGE WAY CO., GREEN BAY, WI, ON BEHALF OF THE NATIONAL MASS RETAILING INSTITUTE; DR. ROBERT E.R. HUNTLEY, PRESIDENT, BEST PRODUCTS CO., INC., RICHMOND, VA, AND A. ROBERT STEVENSON, VICE PRESIDENT, K-MART CORP., TROY, MI

Mr. MILSTEIN. Mr. Chairman, members of the committee, I am Monroe Milstein, chairman of the board of the Burlington Coat Factory Warehouse Corp., headquartered in Burlington, NJ. I am here today also on behalf of the Association of General Merchandise Chains, which represents the Nation's price-competitive general merchandise industry, which includes the Burlington Coat Factory Warehouse.

Following the repeal in 1975 of the so-called "fair trade" laws, which Senator Thurmond was a part of, and even President Reagan approved of the repeal of the fair trade law, which is a price-fixing thing, my company grew from one retail outlet to a present total of 68 stores throughout the Nation. But today, our continued growth and viability are threatened by the possible interpretation that some may place upon the guidelines.

Simply put, there is much verbiage in the guidelines which can be used by the opponents of value-oriented retailers like Burlington to, in effect, reintroduce retail price-fixing under the guise of various vertical restraints.

I note that the guidelines are a vague and confusing document, unintelligible to me as a businessman. This document will permit a variety of practices, which could only result in harm to consumers, small businesses, and off-price merchants.

Section 2.3 of the guidelines states that, "Where an employer adopts a distribution program containing both price and nonprice restraints, the Department will analyze the entire program under the rule of reason. With all due respect, this approach indicates that the drafters of the guidelines are, from a businessman's point of view, totally naive. In my industry, nothing would be simpler for a manufacturer than to formulate a sham system of seemingly neutral vertical restraints that in fact mask a price-fixing arrangement.

A manufacturer faced with the coercion of large retailers could well use the guidelines to withdraw his lines from off-price retailers and then cause the consumers to pay high, full prices.

The entire thrust of the guidelines appears to be directed to industries which bear little resemblance to the apparel industry. The guidelines refer to free riders who undercut full-price merchants, providing highly technical services which may necessitate high retail prices. Anyone who has ever bought a coat, a shirt, or a scarf knows that highly-skilled personnel and technically sophisticated services are not required.

In my experience, my company has frequently been deprived of highly valuable branded merchandise because a large full-price retailer has coerced the manufacturer not to sell to Burlington in certain areas. In many of these areas, Burlington was the only significant off-price retailer. The net result of the cut-off of sales to Burlington has been that in those areas, the only price available to the consumer was the high price charged by full-price stores.

Although I am not a lawyer, I can think of nothing which more clearly constitutes a price-fixing agreement than to coerce such a termination.

Apparel manufacturing is much less concentrated than many other segments of manufacturing. Apparel has traditionally been one of the leading areas of resale price maintenance attempts. It makes no sense to me to rule immune the vertical practices of an industry which has been shown to be subject to pressures against price competition.

Percentages are meaningless numbers so far as the apparel industry is concerned. No single brand commands the market share set out in the guidelines. But as any shopper will tell you, there are consumers who will not patronize a store which does not carry certain branded items. The brand names are initially established through a mass media, such as TV and the airwaves, which are supposed to belong to the public. These advertising campaigns are waged almost entirely by the manufacturers themselves.

Another great problems which the guidelines may cause is discriminatory treatment aimed at off-price merchants. A manufacturer could relieve a favored full-price store from its more vigorous restraints while at the same time imposing those restraints on off-price retailers.

Another defect in the guidelines is the apparent lack of interest on the part of the Department in enforcing the law where improper restraints are merely local, rather than national. From my own experience, what very often happens is that a chain of retailers whose market share is relatively small nationally may be dominant or monopolistic in certain cities or areas. Such a retailer can exclude a company like Burlington from that area, even though it may not be able to do so on a nationwide basis.

In fact, Senator, I have hesitated for some time from opening up in Greenville, South Carolina because of pressures put upon me in the area.

Another basic flaw in the guidelines is the Department's attitude toward the activities of so-called overzealous low-level personnel, as noted in Section 4.224. In my experience, this is a perfect out. Whoever the company orders to do the dirty work now becomes the lower level of management, and yet contact with us is usually done by the buying offices and the sales personnel which are lower level personnel.

The CHAIRMAN. I believe your time is up. Do you want to take one minute and wind up?

Mr. MILSTEIN. All right, I will finish up.

The main thing I would like to say—they keep referring to the Monsanto case. But there is a blatant example of where the Justice Department went in with amicus curiae on behalf of a convicted price fixer, and on the basis of their influence in that particular Monsanto case, they are now holding it up and saying that the Supreme Court is not in opposition to their views on evidence, because of the ruling of the Supreme Court there, it is more difficult for businesses such as mine to go to the private courts and win decisions. It has made it much more difficult than it was before. The entire crux of the price-fixing law, which is illegal per se in this country, is now very difficult for the individual business to see carried out. The free enterprise system is hurt, and the consumer is hurt.

The CHAIRMAN. Are you opposing most of the present law as construed by the Supreme Court, or are you opposing specifically these regulations?

Mr. MILSTEIN. No. I say that the interpretation given by the Justice Department is not the law. Price-fixing as I understand it—and I am not a lawyer—is still per se illegal. But if you let these guidelines—by the way, Mr. Rule said that he wanted these guidelines to be a guide to courts. If you use these guidelines, almost every type of price-fixing can become exempt.

The CHAIRMAN. In other words, you take the position the guidelines are not in accord with the law, as I understand; is that your position?

Mr. MILSTEIN. That is right.

The CHAIRMAN. Thank you.

[Statement follows:]

STATEMENT

OF

THE ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC. (AGMC)

ON

VERTICAL PRACTICES GUIDELINES ISSUED BY THE ANTITRUST DIVISION

PRESENTED BY

MONROE G. MILSTEIN

CHAIRMAN OF THE BOARD AND PRESIDENT

BURLINGTON COAT FACTORY WAREHOUSE CORPORATION

Mr. Chairman, members of the committee, I am Monroe G. Milstein, President of the Burlington Coat Factory Warehouse Corporation, headquartered in Burlington, New Jersey.

I am here today on behalf of the Association of General Merchandise Chains, Inc. (AGMC), which represents the nation's price-competitive general merchandise retail industry, including the Burlington Coat Factory Warehouse. AGMC's membership includes retail companies that operate more than 20,000 discount, variety, dollar, junior department, family center, off-price, factory outlet, catalog showroom and other general merchandise stores. These companies range in size and include many of the nation's largest retail chains as well as companies active in one or more regions of the country. AGMC member company stores are located in all 50 states and account for over $50 billion in annual sales.

The Burlington Coat Factory Warehouse was begun by my father Abe as a wholesale coat business in 1924. This enterprise led us into retailing in 1972, the year we bought the old Modcraft factory outlet on Route 130 in Burlington, New Jersey.

I have been Chairman of the Board, President and a director of the Burlington Coat Factory Warehouse since 1972. Prior to 1972, I was president of Monroe G. Milstein, Inc. (MGM), a wholesaler of outerwear located in New York and a wholly-owned subsidiary of the Burlington Coat Factory Warehouse.

I come before you today to voice my grave concern over the possible impact that the "Vertical Restraint Guidelines" issued by the Justice Department may have on the continued viability of my industry.

Following the repeal in 1975 of the so-called "fair trade" laws, my company has grown from one retail outlet to a present total of 68 stores throughout the nation. Such growth would have been impossible if the old rules permitting resale price maintanence had not be abrogated by Congress. But today, our continued growth and viability are threatened by the possible interpretation which some may place upon the guidelines.

Simply put, there is much verbiage in the guidelines which could be used by the opponents of value-oriented retailers like Burlington to, in effect, reintroduce resale price maintanence under the guise of various vertical restraints. In this regard, I note that the Justice Department has previously attempted to eliminate the per se rule against the vertical price-fixing in the courts.

It may not be the manufacturer who establishes the retail price of the goods, but rather his powerful retail customers, usually one or more full-price store chains. Traditionally, full-price stores employed a markup of "keystone" plus 10 percent or 20 percent, "keystone" being the industry term for double the wholesale price. These traditional full-price stores have found, particularly in the area of apparel sales, that their less efficient operations and approach require them to achieve an overall high gross margin. They are either unwilling to, or incapable of, cutting their costs to meet the competition of the new breed of value-oriented merchants like the Burlington Coat Factory, who are capable of selling the same branded merchandise at a lower markup. As value-oriented merchants, (meaning discount stores, off-price or outlet stores), we purchase the identical brand goods -- at the same time -- from the same sources as do the full-price stores. We have, however, managed to effect operational savings which enable us to offer the same goods at lower prices.

Generally, I have found that many manufacturers are only too happy to sell to our industry because we move more of their merchandise more quickly and increase the manufacturer's profit. The problem arises when the full-price store must shave its prices to meet our competition and cannot achieve their desired gross markup due to their ineffiencies. It is at this point that the higher-priced distributors put pressure on the manufacturers either to fix prices or cease doing business with competitive value-oriented retailers like us.

It now appears to me that the Justice Department is attempting a "back door" approach, under the guise of non-price restraints, to once again raise the specter of resale price maintenance.

I note that I find the guidelines (which the Department says will result in "certainty" concerning the application of law) to be a vague and confusing document, unintelligible to me as a businessman. In all candor, it seems to me that the writers of this document either know nothing about the apparel industry or have forgetten what they knew when they wrote it.

First, although the guidelines pay lip service to the principle that consumers' interests are the primary concern under the antitrust laws, nowhere in the entire document is it explained how the consumer will benefit from the policies the Department is advocating. Indeed, many will interpret this document to permit a variety of practices which could only result in harm to consumers, small business and off-price merchants.

While the guidelines may pay lip service to the <u>per se</u> illegality of resale price maintenance, they also provide a mechanism for resale price-fixing directly by the manufacturer. Section 2.3 of the guidelines states that where a supplier adopts a distributional program containing both price and non-price restraints, the Department will analyze the entire program under the rule of reason. With all due respect, this approach indicates that the drafters of the guidelines are, from a businessman's point of view, totally naive. In my industry, nothing would be simpler for a manufacturer than to formulate a system of seemingly neutral vertical restraints that in fact mask a price-fixing arrangement.

A manufacturer faced with the coercion of large retailers could well use the guidelines to create a sham distributional program with an ancillary price-fixing element inserted at the behest of full-price retailers.
Moreover, the entire thrust of the guidelines appears to be directed to industries which bear little resemblance to the apparel industry. The guidelines refer to "free riders" who undercut full-price merchants providing highly technical services which may necessitate high retail prices. Anyone who has ever bought a coat or scarf knows that highly skilled personnel and technically sophisticated services are not required. Using the broad language of the guidelines, a manufacturer, probably at the behest of the full- price retailer, could adopt totally unneccesary restraints and attempt to justify them under the the guidelines. Indeed, the guidelines appear to encourage such behavior.

The guidelines might also be used to justify other price-fixing agreements. In my experience, my company has frequently been deprived of highly valuable branded merchandise because a large full-price retailer has coerced the manufacturer not to sell to Burlington in certain areas. In many of these areas Burlington was the only significant off-price retailer. The net result of the cut-off of sales to Burlington has been that in those areas, the only price available to the consumer was the high price charged by full-price stores. Although I am not a lawyer, I can think of nothing which more clearly consititutes a price-fixing agreement than such coerced terminations. However, the guidelines contain language which many will argue permits just such activities.

I base this initially upon the guidelines' implication that pressure exerted up the distribution chain by the retailer is illegal only if more than one retailer acts collusively. In the apparel industry, there is no need for retailers to act collusively to force pricing policies on manufacturers. Unlike other industries, the apparel market has traditionally characterized by the so-called "keystone" markup. That is to say, all so-called "regular price" merchants retail their goods at double the wholesale price or even above. Burlington regularly adopts a markup which is 25% below keystone. Since all regular price merchants follow the same markup, they do not need to conspire to let the manufacturer know what prices they favor.

More importantly, the giant full-price store chains have vastly more power over the manufacturer than do Burlington and other small retailers. Throughout the guidelines, the Department continually makes market percentages the "screen" which must be cleared before the Department will even consider action. These percentages have no relationship to the realities of the apparel industry.

The guidelines refuse to recognize vertical price-fixing unless the sellers' or buyers' market shares reach some arbitrary numerical index. I do not presume to judge the appropriateness of that kind of calculation in other areas of the law, for example in analyzing mergers, but it seems to me totally unsuited for analyzing vertical practices that may be part of efforts to fix resale prices.

In the first place, apparel manufacturing is much less concentrated than many other segments of manufacturing. As I understand the Department's guidelines, this would mean that apparel manufacturers would have little or no reason to fear that the Antitrust Division would concern itself with their vertical restraints. Yet apparel has traditionally been one of the leading areas of resale price maintenance attempts. It makes no sense to me to rule out-of-bounds the vertical practices of an industry which has been shown to be subject to pressures against price-competitors.

In short, these percentages are meaningless numbers so far as the apparel industry is concerned.

One reason the market share percentages in the guidelines are irrelevant to the apparel industry is that the true measure of market power in the industry is the consumer's acceptance of name brands. No single brand commands the market shares set out in the guidelines, but as any shopper will tell you, there are consumers who will not patronize the store which does not carry certain branded items. The brand names are initially established through massive media promotion. These advertising campaigns are waged almost entirely by the manufacturers themselves, and not by full-price stores who sometime erroneously claim credit for developing demand for the product.

Once a brand has achieved true customer loyalty, a retailer who doesn't carry that product is at a grave competitive disadvantage. It is here that the largest full-price store chains can coerce manufacturers to deprive off-price merchants of established name brands and thus avoid price competition that benefits the consumer.

The guidelines can be interpreted to permit such unfair competition and "back-door" price-fixing agreements imposed by the retailer or manufacturer. To placate the full-price retailer, the manufacturer may well develop a sham distributional program which directly or indirectly fixes Burlington's prices or deprives Burlington of brand names which are the mainstay of its business.

Another grave problem which the guidelines may cause is discriminatory treatment aimed at off-price merchants. The guidelines appear to condone vertical practices, but nowhere can I find any indication that the guidelines would require such practices be applied across-the-board. In other words, a manufacturer could relieve a favored full-price store from its more vigorous restraints while at the same time imposing those restraints on off-price retailers. The net result once again would be to raise the retail price charged by the off-price merchant and thus undercut its competitive position with respect to full-price retailers.

Another defect in the guidelines is the apparent lack of interest on the part of the Department in enforcing the law where improper restraints are merely local, rather than national.

For instance, the guidelines say that a national manufacturer or distributor operating in many markets may be concerned whether it passes the Department's numerical test in each individual market. So, the guidelines declare:

> the Department will not further scrutinize a firm's entire network of restraints merely because a restraint fails to pass the Step One screen in a small number of markets . . . the Department will view the fact that a firm's restraints pass muster under Step One in most markets as tending to indicate that the restraints in those few markets analyzed in Step Two are more likely to be procompetitive than anti-competitive.

From my own experience, I can state that this approach ignores reality. It very often happens that a chain of retailers whose market share is relatively thinly spread across the country has dominant or monopolistic buying power in certain cities or areas. Such a retailer can exclude a company like Burlington from that area even though it might not be able to do so on a nationwide basis. My attorneys advise me that a violation of the antitrust laws can take place in a relatively small geographic area. The guidelines could be read to encourage high-handed tactics on a local level since the Department has announced that it is interested only in pursuing violators with enormous nationwide market shares.

Another basic flaw in the guidelines is the Department's attitude towards the activities of so-called "overzealous low level personnel" as noted in section 4.224. In my experience, unfair competition is usually provable only at the lower levels of management, that is, through the buying offices and the sales personnel. It is hard enough to obtain evidence of conspiracy at that level; for the Department to confine its efforts merely to the acts of top-level executives would, for all practical purposes, result in the abandonment of the search for price-fixers.

Finally, I perceive a grave problem arising from the guidelines provision that "tying arrangements" will be attacked only where the manufacturer enjoys a 30% market share. I can state that no manufacturer holds a 30% share of a given apparel product line in any significant apparel market. As I said before, the market power that an apparel manufacturer exerts is through the consumer acceptance of its brand and not through the percentage of the overall market.

Under the guidelines, a manufacturer which sells a brand which is crucial to Burlington might be encouraged to force Burlington to buy unwanted and even unsalable merchandise as a condition to the purchase of the established brand. This would, of course, tie up valuable floor space, divert Burlington's buying resources from other more valuable lines, and thus cut Burlington's profit and perhaps force it to raise its consumer- and value-oriented prices.

I have no intention of exhausting the list of flaws we find in the proposed guidelines. I believe that the matters that I have discussed are by themselves sufficient to justify the rejection of those guidelines by accepting the resolution offered by Senators Rudman and Metzenbaum supporting the House's bipartisan H. Con. Res. 128. It is not necessary for us to address the specifics of this resolution since that has already been done. However, we thank Senators Rudman and Metzenbaum publicly for their efforts to protect the consumer and business community from continued attempts to legalize the harmful practice of resale price-fixing. But, in closing, I would simply like to raise a few points about the Department's extraordinary conduct in adopting these guidelines.

In the first place, I am told that no mechanism for public comment was implemented before the guidelines were issued. I know that the Justice Department has admitted that it circulated drafts of this important document for comment to individuals it selected, but that AGMC and other affected retail industry groups were not afforded an opportunity to comment before the guidelines were released, despite their requests to do so. And the Department has not yet revealed exactly with whom it conferred before releasing the guidelines. I suggest that this is indicative of the Department's lack of confidence that its guidelines could withstand public scrutiny.

Second, in the last Congress, it became necessary to pass an appropriations measure which prohibited the Justice Department from attempting to change the per se rule against resale price maintenance in the courts. Just last week, in a bipartisan display of concern, the House Appropriations Committee once again adopted such a restriction, as has the House Judiciary Committee earlier this year in its Fiscal Year 1986 authorization bill for the Department. These actions clearly show that Congress recognizes the benefits that price competition brings to consumers and the economy. I suggest that the drafters of the guidelines have acted contrary to that clear Congressional intent.

The guidelines state that they are intended to influence the outcome of court case, and, as I have testified, much of the guidelines could be read as authorizing a rule of reason approach to thinly disguised price-fixing arrangements. Thus, it seems to me that the Department is again using a "back-door" approach to circumvent the will of this body.

In a well-documented report on its unanimous decision to add restrictive language to the Department's authorization bill, the House Judiciary Committee found that:

> In their rejection of Supreme Court and Congressional consensus through the blurring of the distinction between price and non-price vertical restraints and the development of presumptive rules of their own making, the Guidelines become the instrument of unilateral policymaking going far beyond the powers or prerogatives of an executive branch enforcement agency.

With bipartisan support, the House Judiciary Committee summarized the guidelines as "a portable Amicus brief propounding a novel view of the law." As such, they should be soundly rejected by this Committee and the Congress.

I appreciate this opportunity to appear before you on this important issue.

BURLINGTON COAT FACTORY
ROUTE 130 NORTH
BURLINGTON, N. J. 08016
(609) 386-3314

August 1, 1985

The Honorable Strom Thurmond
Committee on the Judiciary
224 Dirksen Office Building
Washington, DC 20510

Dear Senator Thurmond:

Please find enclosed my response to the six questions which you sent to me as a follow up to my recent testimony before the Judiciary Committee.

I thankyou for the opportunity for having testified and further amplify my thoughts through these questions.

Hopefully, we will have an opportunity to meet with you so that we can discuss our concerns about protecting the consumer from having to pay unnecessary higher prices.

Sincerely,

Monroe Milstein

Monroe Milstein
Chairman of the Board

MM:kt

ANSWER TO QUESTION NUMBER 1

I believe that a resolution expressing Congress' disapproval of the vertical restraint guidelines is essential because, as I have advised this body before, the vertical restraint guidelines issued by the Department of Justice will harm consumers, small businessmen and off-price retailers. Since it is normally the obligation of the Justice Department's antitrust division to enforce the antitrust laws so as to maximize consumer protection and competition in the market and since the guidelines are, in effect, a statement by the Justice Department that it will enforce the law only in the most narrow of circumstances, congressional action is clearly required. The Congress enacted the antitrust laws and the executive branch is obliged to carry them out. The Justice Department, the FTC and other parts of the executive branch have made it clear that they have no intention of carrying out the congressional mandate. Therefore, Congress is the only branch of government that can influence the executive branch to meet its obligation to enforce the law. Simply put, if Congress fails to act, only private individuals can obtain enforcement of the antitrust laws in the courts. It is clearly the intent of Congress that, in enpowering the Justice Department and the FTC to enforce the antitrust laws that individual action is insufficient to insure that the purposes of the antitrust laws are met. Moreover, the guidelines are certain to communicate false signals to the business community as to what is and is not permissable under the antitrust laws. Businessmen who have already embarked upon anticompetitive programs will undoubtedly view the guidelines as a green light to continue in such activities. Indeed, in their broadsweep, the guidelines may very well suggest new anticompetitive vertical activities. Not only may businessmen be encouraged by the guidelines to engage in unlawful conduct, but the guidelines may very well mislead members of the Federal Judiciary as to what the Federal antitrust laws forbid. Itr would be naive to assume that every Federal Judge has had substantial experience, or any experience, with the complex issue involved in antitrust litigation. Judges without antitrust expertise might rely upon the Justice Department's presumed feel for the proper enforcement of the law with the effect that such judges will regard the guidelines as an accurate statement of the law governing vertical restraints. This could result in numerous wrongly decided cases. Furthermore, there are many who believe that the guidelines act as a "portable amicus brief" to be used by those desirous of altering or overturning the existing per se standard. If this is a correct assumption, than the Justice Department has clearly violated the gentleman's agreement with this Congress that they would not use the Courts to alter or overturn the *per se* standard. Finally, the need for Congressional action is underscored by the fact that these guidelines were adopted without any opportunity for the business community to comment upon them. The request by our industry to provide commentary were denied by the department. A firm congressional resolution which will leave the Justice Department no choice but to enforce the law as it has been written and interpreted by the courts is literally the only action which might breing about the Governmental enforcement, which Congress deems essential and will prevent any misconception by businesses or the Judiciary as to the legal effect of the guidelines.

ANSWER TO QUESTION NUMBER 2

In giving my opinion as to how vertical restraints affect consumers, I note at the outset that I speak only for the apparel industry. Although my business expertise is confined to the apparel industry, I have sufficient knowledge of other businesses to know that what might make sense in a totally different line of endeavor has no application to the apparel industry. In fact, as the Justice Department seems to ignore, each industry which involves vertical restraints is characterized by its own idiosyncrasies which render what might be a valild restraint in an industry such as high tecbnology computer sales completely irrelevant to the realitites of the marketplace in the apparel industry. Accordingly, by drafting a set of vertical guidelines which purport to apply to every industry, the Justice Department has displayed a total disregard for the individualized nature of various retailing businesses as well as a complete naivete as to how the marketplace works in the apparel industry. So as not to burden the record, I refer to my testimony to this committee on July 16, 1985, in which I gave a detailed analysis of how the vertical guidelines would adversely affect consumers in the apparel industry. In this response, I will merely allude to some of the more glaring problems created for the consumer by the vertical restraints guide as it is written. Perhaps the most detrimental aspect of the vertical restraints guide is that it would permit certain vertical restraints of a non-price nature to permit vertical price fixing by a backdoor method. Section 2.3 of the guidelines states that where a supplier adopts a distributional program containing both non-price and price restraints, the department will analyze the entire program under the rule of reason. Despite its lip service to the time-honored rule of the Supreme Court that vertical price restraints are per _se_ unlawful, this language indicates that the department is simply attempting to resuscitate its argument before the United States Supreme Court that the _per se_ rule should be abandoned. In my industry, nothing would be simpler for a manufacturer than to formulate a system of seemingly neutral vertical restraints which also contain a price fixing element. For example, a manufacturer might legitimately insist that its goods be merchandised in a certain way and, at the same time, extract a retailer's agreement to sell merchandise at high, uncompetitive prices. According to the language of the guidelines, the rule of reason would be applied to such a ruse. It goes without saying that applying a rule of reason approach to such masked price fixing would harm the consumer. Clearly, the consumer desires to obtain the best price for the merchandise available. The Justice Department's abandonment of the _per se_ rule where price and non-price restraints are present inevitably would result in higher retail prices. Another way in which the guidelines would harm consumers is by treating all low-price merchants as "free riders". The Guidelines proceed on the assumption that there are "free riders" in all industries. As I understand the term, a free rider is one who undersells a dealer or retailer who has provided valuable services such as warranties and installation and instruction to the customer in the operation of the merchandise being purchased. A vertical restraint which prevents free riding in a high technology field may perhaps make sense. It makes no sense in the apparel industry. Highly trained personnel, lavish showrooms and demonstration, warranty and repair services are quite obviously unnecessary for the consumer who, at the risk of sounding facetious, presumably knows how to select and wear an article of clothing. Some consumers desire lavish surroundings and numerous sales personnel to assist them in making their purchases. Such consumers are free to shop at stores that provide such surroundings and personnel. But there are numerous other consumers who are more interested in obtaining the best available price than in the physical appearance of a given store and the amount of personal attention they receive from store porsonnel. Finally, it has been suggested by some that the off-price merchant in the apparel field is a free rider because the large department stores have established the brand name through their advertising and promotional efforts and, accordingly, a low-price merchant is allegedly a "free rider" because it did not have to make the expenditures necessary to establish the brand. This contention is simply false. In the first place, it is the brand which initially establishes itself through its own advertising and marketing. To the extent that large, full-price retailers assist in this, it is through cooperative advertising programs whereby the large retailer obtains substantial paybacks from the manufacturer for advertising its product. The overwhelming number of Burlington's brand name suppliers do not permit Burlington to take part in their advertising programs and thus, it is the full-price retailers who are being given a free ride. Because we are not permitted to advertise the brands by name, we engage in substantial institutional advertising for which we receive no rebate from any manufacturer. Thus, in depicting an off-price apparel merchant as a "free rider" the guideline is not only wrong -- it is describing the opposite of market realities. If companies such as Burlington were permitted to engage in advertising programs in which the cost was shared with the manufacturer, its prices to the consumer would be even lower than they presently are. Thus, the guidelines' misinformed attitude towards what it erroneously views as free riders would again result in higher prices to the consumer and I believe it is self-evident that such would be harmful to the consumer. One final example of how the guidelines could result in vertical restraints which harm the consumer is its failure to provide a regulatory mechanism for dealing with manufacturers who decline to sell to off-price merchants because they have been coerced to do so by full-price retailers. The Guidelines indicate that the Justice Department would take action only in situations where more than one retailer, acting in concert, pressured a manufacturer not to sell to a discounter. This ignores the realities of the apparel industry. There are numerous full-price retailers who, acting by themselves, have the power to coerce a manufacturer not to sell to anyone who undersells the full-price retailer. Where this occurs, the consumer is once again hurt because its only access to particular brands in a given geographical area will be at the full-price retail locations. Thus, once again, the guidelines in their present form could result in harm to the consumer by giving a green light to large retailers to use their power to prevent sales by manufacturers to off-price merchants with the result that the consumer would be forced to pay high, uncompetitive prices.

ANSWER TO QUESTION NUMBER 3

Insofar as the apparel industry is concerned, the so-called Chicago School of Economists could not be more in error when it urges that certain restraints on retail competition are necessary to ensure that consumers obtain desired point of sale services, clean showrooms, good advertising and the like. As I have already indicated, highly sophisticated point of sale services are not required in the apparel industry although they might be in certain high technology fields. ~~Accordingly~~ In addition, no retailer is likely to succeed if its locations are not "clean." Speaking for Burlington, I can attest that our locations are kept impeccably clean without any restraint being placed upon our stores by manufacturers. In the first place, it is simply not expensive to keep a store clean. Secondly, a retailer who allows his premises to become dirty or shabby is bound to fail. Any good businessman -- and only good businessmen should survive in a truly competitive environment -- will incur the minimal costs which Burlington incurs in maintaining the cleanliness of its locations irrespective of any so-called vertical restraints. As for the contention that advertising will not be sufficient absent vertical restraints, the opposite is the case. Burlington spends in excess of ten million dollars a year in advertising. We would spend more except, as I have indicated, name brand manufacturers do not permit us to use their names in our ads so as to protect less efficient full-price stores who wish to avoid our competition. Consumer needs can easily be satisfied by viforous business competition without opening up loopholes for direct and indirect full-price merchants which would not only hurt consumers by artificial high prices but also create an obstacle to new businesses entering the industry which has been the lifeblood of a viable economy in the apparel industry.

price fixers which the guidelines might arguably permit. Such restraints would simply entrench the power of the established

ANSWER TO QUESTION NUMBER 4

Such widespread restrictions would stifle most, if not all, new retail competition which has been generated throughout the history of the apparel industry through the innovations of imaginative retailers. Ironically, when department stores were a novel concept in the industry, they were the innovators and viewed by more antiquated retailers as "discounters" who threatened their hold on the market. Today, many innovations by newcomers to the apparel industry are adopted or acquired by conventinal large retailers. For example, innovative off-price merchants such as Burlington have been able to charge low prices because of the efficiencies of operation and management which they have introduced. Some large retailers have been forced to drop their prices and become more efficient to meet this competition. Both the lower prices of the off-price merchants and those department stores who have attempted to meet competition will disappear if control of the market is given to those few large retailers who have refused to make their operations more efficient to compete in the marketplace and have instead attempted to maintain their artificial prices by interrupting the sources of supply of the innovators. Indeed, whatever they may say in their public announcements, full-price retailers have by their actions shown that they agree that the off-price industry meets the needs of many shoppers and thus have opened their own off-price chains. For example, Dayton-Hudson, a large full-price retailer, has opened two chains called Target and Hervins which are off-price merchants. Nevertheless, some such full-price retailers who have opened off-price chains continue to put pressure on manufacturers not to supply Burlington although they have adopted some of Burlington's Marketing methods.

Moreover, the vertical restraints are constantly viewed by the Department of Justice as emanating only from the manufacturer down the distribution chain. This, too, ignores reality in the market. Most restrictive dealings are at the behest of large full-price retailers who want to maintain the status quo and have induced the manufacturers to adopt restraints on distribution against their will. Because of this faulty premise, the guidelines create numerous loopholes whereby manufacturers will be forced by full-price retailers to restrict output and prevent sales to off-price retailers. In my experience, the overwhelming majority of manufacturers wish to sell as much merchandise as they can produce and are not interested in the nature of their purchasers except with respect to their credit worthiness. Prior to the present administration, when the Department of Justice and the FTC were making a good faith effort to enforce the laws, such manufacturers could respond to pressure from large retailers by saying that it would be illegal to impose the restraints demanded. However, with the implementation of the present guidelines, powerful full-price retailers can respond to manufacturers who have heretofore refused to give in to their demands by pointing to verbiage in the guidelines and stating that the Justice Departmenty views many such restraints to be legal. One net result will be, of course, to restrict supply to price competitive merchants such as Burlington. This will also work to the disadvantage of manufacturers who are desirous of selling the maximum amount of apparel they can produce.

One example of a manufacturer being injured by such high-handed tactics by full-price retailers is evident from Burlington's experience with Butte Knits, a former apparel manufacturer in South Carolina. Burlington had been Butte Knits's largest customer, but because of tremendous pressure put upon Butte Knits by Burlington's full-price competitors, Butte Knits determined to cut off supplies to Burlington. Obviously, Butte Knits must have thought that the full-price merchants were more important to it than Burlington and it could not afford to lose their business. Ironically, despite their pressure on Butte Knits, the full-price retailers in question did not fill the gap in Butte Knits production which Burlington had previously occupied. The result was that Butte Knits closed its facility in South Carolina, thus causing injury to the manufacturer and its employées. This incident merely illustrates a basic law of economics which even Congress, let alone the Department of Justice, cannot repeal. That is, a retailer sells more goods if its prices are low than if its prices are high. If full supplies to off-price merchants are substantially curtailed, an eventuality that would be virtually assured if the guidelines are followed, fewer goods will be produced with the result that off-price merchants, manufacturers, consumers, and ultimately the entire economy will be harmed.

ANSWER TO QUESTION NUMBER 5

Yes. My company has been denied sales of valuable trade name merchandise because of pressure placed on the manufacturer or wholesaler by full-price competitors. On occasions too numerous to recall, we have been advised by manufacturers of quality brand merchandise that our business was not desired because pressure had been received from full-price retailers who are our principal competitors. In some instances, we have had no option other than to go to court to obtain redress. If I were to list the over 50 instances in which a manufacturer had advised us that it could not ship a certain store because a competitor had either pressured them, coerced them or complained to them, I would fill numerous pages of this document. Rather than burden the record, I will point out several instances which we were forced to go to litigation and a few others where we have either been able to persuade the manufacturer that antitrust considerations should cause them to change their mind or we have simply lived with the situation. Presently pending in the U.S. District Court for the Southern District of New York is a case entitled <u>Burlington Coat</u>

Factory Warehouse v. Belk Brothers et al. The extraordinary events that led to the filing of this complaint can be briefly summarized. In 1981 Burlington opened a location in Charlotte, North Carolina, whereupon at least a half dozen of our suppliers who had shipped all or most of our other locations suddenly either refused to ship the Charlotte store or cut off business with us entirely. This case has been in litigation for three years as of this time and the evidence is overwhelming that Burlington was denied merchandise in the Charlotte area because of the coercive pressure put upon our suppliers by an organization called Belk Stores Services, Inc., which is the buying and merchandising arm of an associated group of retailers which maintain more than 400 stores throughout the Southeastern part of the country. I am happy to report that following the initiation of this action and prior to the Monsanto decision, the majority of the manufacturers involved settled with Burlington by agreeing to ship Burlington at a satisfactory number of its locations. However, the case continues with respect to the Belk defendants and another former supplier of Burlington, Jantzen, Inc. Perhaps in reliance on a misunderstanding of the recent Monsanto case, Jantzen has persisted in this litigation despite the fact that there is documentary proof that Jantzen (which had supplied Burlington for over four years at other locations) was terminating Burlington solely because of Burlington's low prices and Belk's threats to terminate Jantzen if such sales to Burlington in Charlotte continued. This case is presently in litigation and we expect a ruling on the law as to whether the case should proceed to trial in the near future.

Another example of Burlington's being deprived of merchandise is presented by the case of Sharon Sez, Inc. (a subsidiary of Burlington) against various divisions and subsidiaries of the Interco clothing conglomerate. Simply put, although Interco's Devon line of merchandise was at all times shipped ~~from other retailers~~ by Devon to Burlington's stores in Long Island where no competitive pressure was received from other retailers, Devon refused to supply Burlington's stores in New Jersey because, according to Devon's own salesman, Devon had been pressured not to do so by other large retailers in the area. This case too is still in litigation. Burlington has also been forced to sue several other retailers and manufacturers on similar grounds.

Apart from these matters which have reached the litigation stage, there have been innumerable instances in which suppliers have requested Burlington to either stop buying altogether or cease its purchases in particular areas of the country where pressure from full-price retailers had been most accute. Within the past two years, a significant brand name supplier of Burlington has asked Burlington to remove its merchandise from stores in East St. Louis, Memphis and Milwaukee because of pressure brought to bear by at least one of the nations largest retailers. Depending upon Burlington's business considerations, we have either acquiesed in curtailing shipments to a particular store or have persuaded the wholesaler in question to continue shipments notwithstanding the threats in question. If Burlington were not such a large entity, capable of employing attorneys who can litigate these questions in a court of law, I doubt that we would have been able to reach an accommodation with any such manufacturers. It is my view that if Burlington -- like so many other off-price merchants -- were a two or three store chain, its business could be cut-off by a manufacturer at the whim of any one of Burlington's large competitors. In any event, Burlington has been constantly requested by various suppliers of men's, women's and children's clothing to refrain from purchasing their merchandise in certain locations or in all locations. Other vendors have simply cut Burlington off rather than incur the wrath of large department store chains. In some cases we have been fortunate in that our attorneys have been able to explain the illegality of the request by the manufacturer to the manufacturer's satisfaction with the result that sales have continued or been resumed. Nevertheless, there are still several manufacturers who will not deal with Burlington at all for the expressed reason that they wish to avoid retaliation from Burlington's full-price competitors.

In closing, I note that pressure from Burlington's full-price competitors has been Burlington's single greatest obstacle to obtaining full supplies of the branded merchandise which are the lifeblood of its business.

ANSWER TO QUESTION NUMBER 6

If the Monsanto case is interpreted in accordance with many recent lower court decisions and the positions taken by the lawyers for certain large department store chains and manufacturers, Monsanto will undoubtedly prove to be an insurmountable obstacle to Burlington's chances of ultimate success in many of the types of lawsuits it has brought and may be forced to bring in the future. Prior to Monsanto, Burlington's legal counsel has advised me that an agreement in violation of the antitrust laws could be proven and usually was proven by circumstantial evidence. Clearly, if a huge department store contacts a clothing vendor and complains of its sales to an off-price merchant such as Burlington and shortly thereafter Burlington is terminated after years of doing business with that vendor, it stands to reason that a jury should at least be permitted to decide whether the complaint caused the termination. According to my attorneys, under traditional antitrust law, if a termination results from an implied threat or complaint, it is inferrable that the parties expressly or impliedly agreed that the termination would take place. Many courts and attorneys for large retailers and manufacturers have interpreted Monsanto to completely dispose of this principle of law. According to some decisions, a case can be thrown out before trial so long as the manufacturer is able to trot out a set of purported distributional policies which, although Burlington had never been advised of them, were the alleged reason for the termination. As a businessman, I know that if a company has supplied my stores for years without any mention of "distributional policies" and suddenly terminated me shortly after a complaint from a huge department store chain, it is obvious that such a manufacturer is terminating me, not because of its "policies", but because of its fear of losing business with the larger full-price retailer. Under some of the broad interpretations of Monsanto, my company cannot even get to a jury unless it can entirely disprove the manufacturer's assertion that it was acting according to its policies rather than in response to the complaints of its large manufacturers. Indeed, numerous defendants have sought summary judgment against Burlington in precisely these circumstances and we are still awaiting the decision of various courts as to whether Monsanto will extinguish our case before trial. Indeed, Monsanto has prompted the filing of a rash of summary judgment motions across the country in the past year. It goes without saying that antitrust actions are among the most costly, time consuming and complex types of Federal litigation. Since Monsanto, such expenditures of time and money has been greatly increased by the necessity for filing weighty briefs and documentary submissions in response to such summary judgment motions. This is particularly alarming in light of the fact that the Supreme Court has stated that Summary Judgment motions should be "sparingly used" in antitrust cases according to information provided by my attorneys. In addition, I note that it is very difficult to prove conspiratorial conduct even absent the Monsanto ruling. Typically, Burlington is advised by a vendor's salesman that it is being cut off because it has received complaints from larger full-price customers. However, human nature being what it is, such sales personnel have invariably denied that they ever made such a statement when they are asked about it in discovery. Given these factors, it is very difficult for any private litigant -- especially a small retailer -- to ultimately prove why a termination occurred. But without the Monsanto standard, we would at least be able to be in a position to let the jury decide whether Burlington's version of the facts is true or that of the accused conspirators. With Monsanto, many of our cases may well be thrown out of court before the jury has an opportunity to determine whether unlawful conduct occurred. Thus, we see Monsanto as a very substantial stumbling block to our ability to effectively protect ourselves in the courts from anticompetitive activities.

The CHAIRMAN. Mr. Jelin?

Mr. JELIN. Good morning, Mr. Chairman, Senator Metzenbaum.

My remarks run about six and three-quarter minutes. In light of the time change I endured last night, I will talk very fast, and I hope you will bear with me.

My name is Stephen Jelin, and I am the president of Prange Way Stores. We are a 20-store chain of discount department stores in Wisconsin and Illinois, and we are a division of the H.C. Prange Co. which also operates 20 conventional department stores and 40 specialty stores in six Midwestern States.

Our aggregate volume was about $400 million in 1984, and it is our very diversity of retail operations that puts us in an almost unique position to speak to you today about vertical restraints guidelines.

I appear also on behalf of the National Mass Retailing Institute, the NMRI, which is a retail trade association whose members' sales constitute much of the $100 billion a year U. S. discount retail industry with more than 15,000 member stores in all 50 States.

Because the guidelines substantially impact our industry, we offer you our views, and though I of course shall not read my prepared text; may, I ask that it be included in the record?

The CHAIRMAN. Without objection.

Mr. JELIN. Thank you.

As you well know, both Congress and the courts have declared resale price maintenance per se illegal, and as you also unhappily know, we collectively—Congress, the retailers, the manufacturers and the consumers—have been hassling this issue in one guise or another with the enforcement agencies for the past 4 years. Despite Congress' explicit directives that the Justice Department desist in its assaults on antitrust law in the vertical restraints and particularly in the vertical price-fixing area, the Department of Justice has spent nearly three personyears drafting these vertical guidelines while prosecuting no price cases and only seven vertical cases, by its own count.

These guidelines were published in draft form in November 1984, and were circulated to a select group of private parties for review. They were not made available to Congress, nor to the discount retail industry; in fact, they were specifically and purposely not communicated to those two groups, two groups with obvious and important interests in the matters contained in the guidelines.

Mr. Rule said today that Justice "welcomed comments"—yet Justice expressly rejected specific offers by NMRI to comment and did not solicit or circulate comments before promulgation.

Despite the Department of Justice's disclaimer that nothing in the guidelines "changes the law in any way, nor is any change recommended," and despite the allegation that resale price maintenance is "not treated in the guidelines," these vertical guidelines do in fact erode the per se rule.

Let me flag just one of several examples from my written text. The guidelines, as Senator Rudman this morning so clearly articulated, substantially blur the distinction between price and nonprice restraints. They create a presumption that, if price and nonprice restraints are lumped together, the Department will analyze the entire program under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies, and if the price restraint is "merely ancillary" to the nonprice restraint.

By injecting the rule of reason standard back into the enforcement guidelines—albeit this time under the worrisome, loose and rather suspicious guise of deciding whether price-fixing is "merely ancillary" to nonprice intentions—the Justice Department seems to me to be coming around the side door to accomplish exactly what was rejected resoundingly by the Supreme Court in *Monsanto*. That side door, to vary Senator Metzenbaum's rather apt metaphor, is a barn door wide enough to drive a large, anticompetitive tank through; and I think the free market is imperilled thereby.

The guidelines do even more damage than that. In my opinion, and in the judgment of antitrust scholars, "certaint," Mr. Rule's purported purpose, is a most unlikely result of these particular guidelines. As noted by former Assistant Attorney General Thomas Kauper in his testimony before the House Judiciary Committee, these guidelines are "complex to the point that I seriously doubt their utility to business planners".

I have read them, and as a professional business planner, I totally agree with Mr. Kauper.

Let me stress that my concern is not merely a special interest or a parochial pleading here. "Certainty" is required on both sides of the distribution relationship—that is, our suppliers need to know when they can reject improper customer pressures to engage in anticompetitive activity. From my curious perspective of 15 years as an executive in retailing, and 10 years prior thereto as a practicing lawyer, I can assure this committee that, generally without exception, our suppliers want to stay on the right side of the law. Some of our suppliers are occasionally pushed to the very brink of legality when certain powerful distributors of their product insist on favors and anticompetitive treatment.

But I urge you that any message sent to those who would engage in any anticompetitive activity must be clear and convincing.

The CHAIRMAN. Your time is up. Can you finish in a minute and summarize?

Mr. JELIN. I will do my best.

The per se rule is exactly such a clear message. The Division's guidelines obscure that message dangerously, and it seems to me that they may in fact constitute a contrary message, for they seem to signal to manufacturers that virtually all vertical restraints may now be presumptively lawful.

It seems to me that the consumer is the best judge of whether she or he wants to pay more for technical consultation and expertise with her product or less without it. And I assume that those consumers' choices resonate loudly and clearly in the free marketplace.

An unproven and suspect theory like the free rider theory should not be intruded into this free market system by Executive agencies.

In conclusion, my prepared text details the four actions which the discount industry, through NMRI, urges this Committee to do: One, to support the Fish bill, thereby reasserting that the Antitrust Division has no power to change existing laws arbitrarily; two, to support the resolution announced by Senators Metzenbaum and Rudman this morning, expressing disapprobation of these unfortunate guidelines; three, to support the much-needed bill being introduced by Senators Rudman and Metzenbaum, to clarify the present uncertain conspiracy standards set down in Monsanto, and four, to urge an intensive examination of any candidate for Assistant Attorney General for Antitrust as to his or her views specifically on the resale price maintenance issue and on the Division's duty to maintain and enforce established law.

Thank you very much.

The CHAIRMAN. Thank you.

[Statement follows:]

TESTIMONY OF STEPHEN J. JELIN
PRESIDENT OF PRANGE WAY STORES
ON BEHALF OF THE NATIONAL MASS RETAILING INSTITUTE
AND PRANGE WAY STORES
BEFORE THE SENATE JUDICIARY COMMITTEE

Mr. Chairman and distinguished members of the Committee, my name is Stephen J. Jelin, and I am President of Prange Way Stores, a 20 store chain of full-line discount department stores in Wisconsin and Illinois, and a division of the H.C. Prange Company, which also operates 20 full-line conventional department stores in Wisconsin, Illinois, and Michigan and 40 ladies' specialty stores in 6 midwestern states. Our aggregate volume from these diverse retail outlets was almost $400 million in 1984; and it is that very diversity of our operations that puts us in an almost unique position, among NMRI's member discount chains, to speak to you today about VERTICAL RESTRAINT GUIDELINES [redacted] and the mass retail industry.

I am pleased to have this opportunity, on behalf of both the National Mass Retailing Institute (NMRI) and Prange Way Stores, to share our concerns about the Justice Department's Vertical Restraint Guidelines issued on January 23, 1985.

NMRI, of which Prange Way is a member, is a retail trade association whose members' sales constitute an overwhelming majority of the 100-billion-dollar-a-year U.S. discount retail industry. NMRI represents over 125 discount retail chains who, collectively, operate more than 15,000 stores in all 50 states.

NMRI's member stores, generically known as "mass merchants", operate at lower profit margins by selling more goods -- including brand name goods -- at discounted prices, usually below manufacturers' suggested list prices. As has been much publicized, the discount retail industry has enjoyed explosive growth in the last two decades ... and I would like to suggest a simple and principal reason for this growth: American consumers have turned to discount stores because these stores offer an attractive combination of low prices, product choices, and desired services. We are, therefore, vitally interested in any proposed revisions to laws governing the distribution of goods -- revisions which could unnecessarily curtail our access to goods and our methods of selling. Such revisions, I submit, are implicit in the Department of Justice's Vertical Guidelines.

Because the Guidelines impact substantially on our industry, we offer our views. We first discuss the recent history of this controversy, the substantive errors in the Guidelines, and our recommendations for Congressional response.

THE VERTICAL GUIDELINES: THEIR HISTORICAL CONTEXT

Congress, too, has long been concerned with the antitrust laws regulating the distribution of goods. In 1975, Congress enacted the Consumer Goods Pricing Act, Pub. L. No. 94-145, 89 Stat 801 (1975) (amending 15 U.S.C § Section 1, 45(a) (1976)), repealing certain federal statutes and thereby revoking the states' authority to allow resale price fixing.

The testimony presented during the House and Senate hearings on the Consumer Goods Pricing Act compelled the conclusion that resale price fixing was causing great economic damage: (1) the practice added to the costs borne by consumers, thereby increasing inflation; (2) it facilitated price-fixing by manufacturers; (3) it retarded the growth of efficient forms of retailing and added unnecessary costs to distribution; and (4) it was not necessary to accomplish any desired social end.

The Antitrust Division of the Department of Justice, the Federal Trade Commission, and President Gerald R. Ford were prominent in leading the charge against resale price fixing. Ronald Reagan, then writing for the Copley News Service, also decried the practice. In a column reprinted in the Congressional Record of January 23, 1975, Mr. Reagan condemned resale price fixing and called the "setting [of] minimum prices... [a] trick." He agreed that resale price fixing stifled competition, added to inflation, and was not necessary to ensure extra service to consumers. In the words of Senator Strom Thurmond in 1975, the Consumer Goods Pricing Act was necessary because "Congress [could not] continue to sanction price fixing...."

Despite Congress' clear statement in 1975, the Antitrust Division of the Department of Justice, commencing in 1981, began a prolonged attack on the rules prohibiting anti-competitive vertical restraints, including the per se rule prohibiting resale price maintenance. Because of the Antitrust Division's disturbing conduct -- particularly that of former Assistant Attorney General William Baxter -- Congress has been forced repeatedly to instruct the Antitrust Division to enforce those antitrust rules governing the distribution of goods, notably the per se rule prohibiting resale price maintenance.

For examples:

- In 1983, in the 1984 Appropriations Bill for the Departments of Commerce, Justice, and State, the Judiciary and Related Agencies (H.R. 3222), Congress -- in bipartisan, unanimous votes -- specifically instructed the Department of Justice not to expend any funds to alter or overturn the per se rule prohibiting resale price maintenance. That timely legislation prevented Mr. Baxter from pursuing a planned argument to the Supreme Court to scrap the rule of law prohibiting resale price maintenance.

- In 1984, Congress -- again in a bipartisan, unanimous spirit -- instructed the Department of Justice and the Federal Trade Commission to adhere to the per se rule prohibiting resale price maintenance. The conference report on H.R. 5712 contained language noting the repeated assurances of then Assistant Attorney General J. Paul McGrath that the Department would not seek to alter or limit the existing per se rule unless or until the Supreme Court first made such a substantive change. The Conference Report also noted that the conferees expected the Antitrust Division and the Federal Trade Commission to report to the Senate and House Appropriations Committees twice a year concerning their resale price maintenance enforcement programs.

DEPARTMENT OF JUSTICE PROMULGATION OF VERTICAL GUIDELINES

Despite Congress' explicit directives that the Department of Justice desist in its assaults on antitrust law in the vertical restraints area, notably vertical price fixing, the Department of Justice has spent nearly three "person years" drafting the Vertical Guidelines. Those guidelines were published in draft form in November, 1984 and circulated to a select group of private parties for review. They were not made available to Congress, nor to the discount retail industry (in fact, they were specifically and purposely not communicated to those two groups) -- two groups with obvious and important interests in the matters contained in the Guidelines. The Justice Department released the Vertical Guidelines in January, 1985.

As I hope to demonstrate, the Guidelines, while purporting to deal only with non-price vertical restraints, and while purporting to acknowledge the *per se* rule, in fact do address price restraints and seriously erode the *per se* rule condemning resale price fixing.

Indeed, the House Judiciary Committee, having scheduled prompt hearings because of the seriousness of the issues raised in the Guidelines, has recently issued an extensive report criticizing the Guidelines. Concludes the House Judiciary Committee report:

> ...the Guidelines are inconsistent with existing law and are also demonstrably unsound as a matter of policy. In their potential to encourage, or at least provide "official" sanction for business practices that may reduce the range of consumer choices and the market viability of both manufacturers and dealers, the vertical guidelines threaten to impose significant costs on consumers. And their rejection of Supreme Court and Congressional consensus through the blurring of the distinction between price and non-price vertical restraints and the development of presumptive rules of their own making, the Guidelines become the instrument of unilateral policy-making going far beyond the powers or prerogatives of an executive branch enforcement agency.

Out of the House hearings on the vertical guidelines grew several important developments. First, Representative Hamilton Fish introduced a bill (H.R. 1467), with substantial bi-partisan support including Representatives Shaw, Seiberling, Edwards, and Hyde, that would require public notice and comment for the issuance of all antitrust guidelines by the Department of Justice. NMRI strongly supports that bill. Second, Rep. Fish also introduced H. Con. Res. 128, which expressed the sense of Congress that the Guidelines do not have the force of law, do not accurately state current antitrust law, and should not be considered binding or persuasive by the judiciary. NMRI strongly supports that resolution. Several Senators, we understand, will shortly introduce two measures which NMRI will vigorously support: (1) a bill clarifying the standards for proving a resale price maintenance conspiracy and affirming the *per se* rule and (2) a resolution which, like Rep. Fish's resolution, will request withdrawal of the Vertical Guidelines.

With this brief background in hand, we turn to a few substantive concerns raised by the Vertical Guidelines.

VERTICAL GUIDELINES: SUBSTANTIVE CONCERNS

On March 7, 1985, NMRI testified before the House Judiciary Committee and, at that time, submitted extensive written comments discussing errors of law and policy found in the Vertical Guidelines. I have attached a copy of our previous testimony to today's remarks. Without burdening you by repeating that statement, let me briefly highlight a few comments:

(1) The Vertical Guidelines erode the per se rule prohibiting resale price maintenance.

Despite the Department of Justice's disclaimer that nothing in the Guidelines "changes the law in any way, nor is any change recommended", and despite the allegation that resale price maintenance "is not treated" in the Guidelines, the Vertical Guidelines do, in fact, erode the *per se* rule. I offer several examples of troublesome language in the Vertical Guidelines which severely impact the per se rule:

First, the Guidelines blur the distinction between price and non-price restraints. They create a presumption that, if price and non-price restraints are lumped together, the Department will "analyze the entire program under the rule of reason if the non-price restraints are plausibly designed to create efficiencies and if the price restraint is merely ancillary to the non-price restraint." (Guidelines at page 11) (emphasis added). By injecting the "rule of reason" standard back into the enforcement guidelines, albeit this time under the worrisome guise of deciding whether price-fixing is merely ancillary to non-price intentions, the Justice Department seems to me to be coming around the side door to accomplish precisely what was espoused in its brief and rejected resoundingly by the Supreme Court in Monsanto. That side-door is, in fact, a barn-door wide enough to drive a huge anti-competitive bull-dozer through, if the Justice Department's "interpretative staff" is as zealous and clearly directed as its current "enforcement staff" has been. If price-fixing can be a "plausible efficiency" because the staff finds it ancillary to other non-price restraints, then illegal price-fixing will become legal by staff interpretation of guidelines, and by executive department direction; and the retail industry and the consuming public and free enterpise will all be the losers for it!

Second, the Division suggests that vertical price fixing is lawful so long as the agreement to fix prices does not set "specific" resale prices. That is, the Guidelines state that if a supplier adopts a distribution program embodying both price and non-price restraints, the program will be issued as a non-price restraint unless there is "direct or circumstantial evidence (other than effects on price) establishing an explicit agreement as to the specific prices at which goods and services would be sold." (Guidelines at page 10). Such a statement is at odds with Supreme Court precedent which permits consideration of the effects of a restraint on price in determining whether or not there is a price fixing agreement.

Third, the Guidelines suggest that, where competing dealers of the same brand of products together adopt a restraint, such a restraint will be considered "vertical" rather "horizontal." (Guidelines at pages 7-8). This suggestion, too, is at odds with Supreme Court precedent prohibiting dealers from jointly adopting a restraint pertaining to a single brand.

Fourth, the Guidelines suggest a defense to a resale price maintenance charge that the conduct was only the activity of a "low-level employee" with little ability to influence decisions. (Guidelines at pages 36-37). This statement, too, ignores established judicial precedent permitting an antitrust conspiracy to be based upon conduct of any employee. Indeed, in my experience in the retail business, I have found it frequently the case that distribution decisions are both made and significantly influenced daily by the conduct of vendor salesmen, precisely the kind of "low-level employees" which the Department of Justice would ignore.

(2) The Vertical Guidelines do not increase business certainty.

The stated purpose of the Guidelines is to contribute "to the orderly development of vertical restraints case law, and ...[to] reduce the uncertainty associated with enforcement of the antitrust laws in this area."

In my opinion and in the opinion of antitrust scholars, certainty is an unlikely result of these guidelines. As stated by former Assistant Attorney General Thomas Kauper in his testimony before the House Judiciary Committee, the Guidelines are "complex to the point that I seriously doubt their utility to business planners." Mr. Kauper, I believe, captured the Antitrust Division's true purpose in formulating the Guidelines. He stated that the Guidelines were not intended to serve the purpose of assisting buisness planners but "are more in the nature of an amicus brief, designed primarily to influence courts in private cases to which the Division is not a party." The Guidelines, in short, recommend a departure from current standards and, hence, confuse businesses as to where the law stands.

Let me stress that my concern is not merely special interest or parochial pleading. Certainty is required on both sides of the distribution relationship. That is, our suppliers need to know when they can reject improper customer pressures to engage in anti-competitive activity. From my curious perspective of fifteen years as an executive in the retail industry, and ten years prior thereto as a practicing lawyer, I can assure this Committee that, generally without exception, our suppliers wish to stay on the right side of the law. Some of our suppliers are occasionally pushed to the very brink of legality when certain powerful distributors of their products insist on favored--and anticompetitive -- treatment. I urge you that any message sent to those who would engage in any anti-competitive activity must be clear and convincing. The per se rule is just such a message. The Division's Guidelines obscure that message dangerously... and they may, in fact, constitute a contrary message. These Guidelines signal manufacturers that virtually all vertical restraints may now be presumptively lawful and that the burden of proof on any potential plaintiff is so difficult, time-consuming, and costly that successful litigation would be unlikely. I believe it would be socially far more desirable to leave on a potential wrong-doer the burden of thinking twice carefully about whether his act were unlawful before acting.

It is my understanding that there has been little, if any, lobbying in Congress by manufacturing groups on these resale price maintenance issues. I think that most suppliers have concluded that retailers may well be best situated to make many distribution decisions, especially the decision at what price goods should be sold. I urge this Committee, therefore, to restore certainty, both for the manufacturer and for the retailer, by declaring once and for all that resale price maintenance is illegal. To the extent that the Vertical Guidelines inadvertently or purposely confuse this rule of law, they need to be rejected forthrightly and unequivocally.

(3) The Vertical Guidelines are premised on theory, not fact.

Anyone who reads the Vertical Guidelines is left with an impression that only an expert economist, equipped with voluminous data and sophisticated computers, will be able to make any sense of these Guidelines. The proposed Vertical Restraint Index (VRI) is a hypothetical construct, poorly equipped to take into account the peculiarities of any particular distribution question. I have tried to examine, and understand, and to imagine complying with the onerous burdens of proof which the Guidelines heap onto any terminated distributor. I can only tell you, in complete candor, that our company, which is of moderate size but not without considerable resources, would find such proofs almost impossible to supply and prohibitive in cost.

Moreover, the Guidelines as a whole appear to rely on unfounded presumptions as support for the proposition that vertical restraints are ordinarily pro-competitive. For example, the Guidelines state (page 15):

> Limiting the number of distribution outlets may be the most efficient method of ensuring the provision of pre-sale demonstration and other informational services that consumers want and that are necessary to effective marketing of a technically complex product. In those circumstances, in the absence of vertical restraints, a dealer may invest too little in such services because other dealers that do not provide the services may "free-ride" on the services that the dealer has provided. By reducing the threat of free-riding, vertical restraints may enable a dealer to capture a significant fraction of the increase in total demand that is generated by his investment in informational services and, therefore, encourage dealers to expend the effort required to provide those services.

This statement is a wholesale adoption of the notorious "free-rider" theory as a purported justification for <u>all</u> vertical restraints, including price restraints. From my perspective, I seriously doubt the [redacted] VALIDITY of the free-rider theory. The literature of which I am aware, and my own hands-on experience, tell me that consumers rarely, if ever, take advantage of the services of one outlet and then purchase the product elsewhere; and I ~~say that to you even though~~ KNOW THAT TO BE TRUE BECAUSE my company operates full-service department stores that are adjacent to, and in many cases, even share premises with our discount stores, both carrying the same identical merchandise. Customers usually buy products, even sophisticated computer products, at the stores where they received the initial demonstration. Further, price competition and good service can, and do, go hand-in-hand in most cases. For years discount retailers have been selling complex products. Our stores, for example, carry a substantial line of consumer electronics, a limited selection of personal computers, a fair choice of telephonic equipment, alot of diverse small appliances, an impressive array of cameras and sight and sound equipment, and alot of other such merchandise that requires technical knowledge on the part of the purchasing consumer. We provide what TECHNICAL DATA + INFORMATION we can, within the constraints that a no-frills, self-service, low-margin operation imposes, primarily in the form of clearly presented manufacturer-supplied information; and we back our commitment to our customer with a "satisfaction guaranteed, no questions asked refund policy." We are hardly "free-riders"; and we sell a great deal of merchandise to a large number of satisfied customers who want to shop for both items and prices.

The whole "free-rider" concept is particularly troublesome to me, with my personal background in apparel retailing, when I find it being used as a kind of intellectual stretcher-bar to extend the notion of permissible price restraints to cover apparel and health and beauty aids and candy, and all sorts of categories to which it is patently not a bit relevant... and equally patently anti-competitive in its effect.

The consumer is the best judge of whether she or he wishes to pay more for more technical consultation and expertise with her product, or less without it. And I assure you that the consumer's choices resonate loudly and clearly in the free marketplace. Most discounters have gone out of the expensive personal computer business because most customers for that commodity made it clear that they would prefer to pay more elsewhere. However, other sophisticated electronics businesses, like television sets and microwave ovens, are appropriately carried by both discount and non-discount outlets and an unproven AND QUESTIONABLE theory like "free-rider" should not be intruded into this free market system BY AN EXECUTIVE AGENCY.

The Need For Congressional Action

The resale price maintenance debate and vertical restraints debate has been raging for many years. Congress, for which I am grateful, has consistently taken the view of the consumer and the discount retailers, to wit: that certain vertical restraints are inherently anti-competitive, cause injury to consumers, and should not be tolerated. The Antitrust Division, I am sorry to say, is stubbornly on the other side of this debate. Even in the face of repeated Congressional directives, the Antitrust Division has taken every opportunity to erode the law, either by direct frontal attack, as in the amicus brief in Monsanto v. Sprayrite, or when that proved unsuccessful, then by indirection such as through these Vertical Guidelines. Unfortunately, now Congress must again act.

NMRI urges this Committee to support the following measures:

(1) The Fish Bill

We believe that the Antitrust Division should not be permitted ARBITRARILY to change established antitrust rules. LAW-MAKING is best reserved TO Congress. Moreover, we are particularly disheartened that the Justice Department would issue Vertical Guidelines without consulting members of an industry directly affected by such guidelines, even after members of the industry volunteered their in-put. Thus, we urge that this Committee favorably consider legislation, such as the Fish legislation, which would prohibit the Justice Department from issuing antitrust enforcement guidelines without public review and comment. We emphasize that these guidelines have already been cited in actual cases by the Justice Department (in the Tom's Foods case) and private litigants (in Buckingham v. Odom) as support for changes in the law. The Guidelines do not, thus, represent a mere statement of beliefs or a summary of existing law; they are now being actively asserted as legal rules.

(2) The Fish Resolution

NMRI believes that the Vertical Guidelines ought to be withdrawn. That is the thrust of a resolution introduced by Rep. Fish and soon to be introduced in the Senate. We applaud that effort and encourage this Committee to support it.

(3) Monsanto Bill

Last year, the Supreme Court upheld the validity of the *per se* rule in the *Monsanto* case. However, some language in that opinion suggests that resale price maintenance conspiracies are to be judged by a different standard of conspiracy law than that applied to other conspiracies. Like the Vertical Guidelines, some of the Supreme Court language in the *Monsanto* case could be misconstrued in such a way that resale price maintenance will go unpunished. Thus, in connection with Congress' assertion of its long-standing views in this area, we urge this Committee to take the opportunity to support a bill to be introduced in the Senate which would clarify the standard of conspiracy law to be applied in resale price maintenance cases.

(4) Nomination Hearing

It is reported that the President will shortly submit to this Committee his selection for the now-vacant position of Assistant Attorney General for Antitrust. In light of the Antitrust Division's conduct over the past several years, we urge the most thorough and intense examination of this candidate for her or his views on resale price maintenance. Indeed, NMRI respectfully suggests that this Committee ought to demand firm commitments from the nominee as new head of the Antitrust Division that (1) resale price maintenance cases will be brought by the Division, regardless of the alleged insignificance of the industry affected or the availability of a private treble damage remedy; (2) speeches and policy statements will not be made suggesting the invalidity of the *per se* rule; and (3) the Vertical Restraint Guidelines will be withdrawn.

PRANGE WAY

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Stephen J Jelin
President

August 16, 1985
"Our 98th Year"

The Honorable Strom Thurmond
Chairman
Committee On The Judiciary
United States Senate
Washington, DC 20510

Dear Senator Thurmond:

Thank you once again for your attentiveness during my testimony at the July 16, 1985 Judiciary Committee Hearing on the Department of Justice's Vertical Restraints Guidelines.

In response to your request of July 18, 1985, on behalf of Senator Metzenbaum, which did not reach me unfortunately until August 5, 1985, I am enclosing answers to the questions you propounded. I hope they will be helpful. I have tried to make them brief and not to repeat the material enclosed in my oral and written testimony.

Very truly yours,

Stephen J. Jelin

SJJ/pg

Draft Responses to Thurmond's Questions

Q. Why do you feel you need a Congressional Resolution concerning the Vertical Restraint Guidelines?

A. As indicated in my testimony, I believe that the Vertical Restraint Guidelines do not accurately state the law of the land pertaining to vertical restraints. Yet, the Justice Department and private litigants are already citing the Vertical Restraint Guidelines to courts as authority. In my opinion, Congress must indicate beyond any doubt to the government enforcement agencies, to the courts, and to the private bar that the guidelines, to the extent that they vary from the will of Congress and judicial precedent, are not the law. Because it appears that the Justice Department will not voluntarily withdraw the guidelines, Congress must expressly renounce them in order to send this message.

Q. How do vertical restraints affect consumers?

A. Vertical restraints curtail intrabrand competition. For example, the guidelines suggest that all Chevy dealers in a city could agree not to compete, thereby preventing consumers from shopping for the best terms and conditions for purchase of a Chevy. Curtailing intrabrand competition will necessarily raise prices and injure consumers.

Q. Chicago School theorists claim that these restraints on retail competition are necessary so that consumers get desired point-of-sale services, clean showrooms, good advertising, etc. Do you agree?

A. I agree that manufacturers may insist that their retailers provide certain point-of-sale services, clean showrooms, and good advertising. I disagree that the Vertical Restraint Guidelines necessarily promote these services. I respectfully suggest that, if a manufacturer insists on such requirements, he can compel them by contract. It is not necessary for a manufacturer to eliminate competition among its dealers to guarantee that such services will be performed. Eliminating intrabrand competition, in fact, is no guarantor whatsoever that services will be performed. In my opinion, eliminating intrabrand competition may often produce just the opposite result: a retailer, free from competition, will not be compelled by the marketplace to do the best job on either price or service.

Q. Throughout the years, we have seen innovations in retailing like supermarkets, discount stores, factory outlets, catalog showrooms, all vigorously opposed by existing retail merchants. If these Vertical Guidelines succeed in encouraging widespread restrictions, what affect will this have on retail competition and new innovations that benefit the consumer:

A. As indicated in my answer above, I believe that competition inspires performance. All of the examples cited in this question were, in origin, new forms of price competition. To the extent that the Vertical Guidelines diminish competition, it is my belief that the guidelines will retard innovation in retailing. Without such innovation, consumers will inevitably be restricted in choice and disadvantaged.

Q. Have you been denied the ability to sell a product because of pressure placed on the manufacturer or wholesaler by your high-price competitors.

A. Based on my 17 years experience in the retail industry, I believe that the two companies for which I have worked have several times been victims of pressure on manufacturers by our competitors.

Q. What effect does the Monsanto case have on your ability to sue when victimized by price-fixing conspiracies.

A. In my opinion, the Monsanto case is helpful in affirming that resale price maintenance is per se illegal. However, I believe that the Monsanto case also incorrectly places a difficult burden on retailers by requiring them to disprove, as part of their prima facia case, any possible explanation for termination. I think that a more appropriate burden in a price-fixing case would allow a retailer who has demonstrated termination following complaints to present his argument to the jury, and for the manufacturer who claims a non-price reason for that termination also to present its version to the jury. In my opinion, the Monsanto case strips the jury of its traditional function as fact-finder; and, in so doing, makes any successful prosecution of such cases substantially more difficult.

TESTIMONY OF ROBERT J. VERDISCO
VICE-PRESIDENT FOR
GOVERNMENT RELATIONS
NATIONAL MASS RETAILING INSTITUTE
BEFORE THE
HOUSE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON MONOPOLIES
AND COMMERCIAL LAW
UNITED STATES HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

March 7, 1985

Mr. Chairman and distinguished Members of the Committee, my name is Robert J. Verdisco, and I am Vice-President of Government Relations for the National Mass Retailing Institute (NMRI). NMRI is a retail trade association whose members' sales constitute an overwhelming majority of the 100 billion dollar a year U.S. discount retail industry. NMRI represents over 125 discount retail chain members who, collectively, operate over 15,000 stores in all 50 states.

NMRI members share a single, but powerful, business philosophy: American and international marketplaces should be open, free, and competitive. In keeping with this philosophy, NMRI members strive to provide the American consumer with access to the widest possible range of international and domestic goods and services through the most successful system of discount department stores in the world. NMRI member discount retail stores efficiently and effectively distribute these goods and services and provide consumers the freedom to select quality goods and services at fair and competitive prices.

NMRI is pleased to have this opportunity to share with you today our concerns with the Justice Department's new Vertical Restraint Guidelines issued on January 23, 1985.

As many members of this Committee are aware, NMRI came before you on March 10, 1983, to discuss the very issue which we are addressing today: resale price maintenance and the government's abdication of its enforcement responsibilities. As a result of those hearings, and the clear bipartisan direction that this Committee gave to the Department of Justice, we believed that the duty of the Antitrust Division to enforce the *per se* rule against resale price maintenance was settled. Our belief was mistaken. Again, in 1983 and 1984, the Joint Committee on Appropriations specifically directed the Department of Justice and Federal Trade Commission to stop trying to change the antitrust laws, including the per se rule against resale price maintenance. We thought at that time that the Department of Justice would abide by the wishes of Congress. Again we were mistaken. Now it appears to us that with the issuance of the Guidelines and the lack of enforcement activity, the Department of Justice is once again striking out to set its own antitrust policy. Hopefully, Congress will see fit to now resolve this matter once and for all.

We are here today to express our concerns with both the substantive issues addressed in the Guidelines and the process by which they were developed.

ISSUE RELATED CONCERNS

First, we are concerned with the impact the Guidelines have on key antitrust issues including the longstanding per se rule against resale price maintenance. While the Department claims that the new Guidelines deal only with non-price vertical restraints, we believe that there are strong signals to the contrary.

1. The Guidelines fail to emphasize sufficiently the continued validity of the per se prohibition against vertical price fixing.

Throughout the Guidelines, sweeping statements incorrectly suggest that all intrabrand restraints are permissible, and, indeed, encouraged. While there is token reference to the per se rule with respect to resale price maintenance, a reader cannot help but believe that the Antitrust Division hopes eventually to overcome that rule.

For example, one searches in vain in the initial portions of the Guidelines for the recognition that vertical price fixing is illegal per se. The Guidelines' first footnote does acknowledge that resale price maintenance "is not treated" in these Guidelines, but the Antitrust Division fails to take that opportunity to emphasize that the practice is illegal per se. Further, in a discussion of the per se rule generally, at pp. 4-6, the Guidelines again fail to mention that resale price maintenance is illegal per se . Instead, the Guidelines concentrate on the per se rule in horizontal cases. Not until page 10 do the Guidelines make an off-hand reference to resale price maintenance, and the Guidelines' statement is hardly an endorsement of that rule of law:

> For many years resale price maintenance has been held to be illegal _per se_, and so these guidelines do not apply to resale price maintenance.

In marked contrast to the tepid recognition of the _per se_ rule, the Guidelines make overbroad statements on the _legality_ and pro-competitiveness of all vertical restraints. For example, Section 3.2, while captioned "_Anticompetitive_ Effects of Vertical Restraints", ironically commences with the proposition that ". . . vertical restraints generally have a procompetitive or competitively neutral effect . . ."

Such sweeping statements fail completely to condemn vertical _price_ restraints and thereby ignore decades of teaching on the pernicious effects of resale price maintenance. _The Antitrust Division, it would appear, sees its role more as defending certain restraints than prosecuting anti-competitive conduct long condemned by Congress, the Courts, and previous Antitrust enforcement officials._

We believe that by the Guidelines' failure to endorse emphatically the rule of law that resale price maintenance is illegal _per se_, the Antitrust Division is inviting manufacturers to consider that practice. Indeed, the Guidelines seem to invite the repeal of the _per se_ rule prohibiting resale price maintenance. It is to that point which we next turn.

2. The Guidelines invite the rejection of the _per se prohibition against price fixing._

In many instances, the Guidelines rely on unfounded presumptions as support for the proposition that vertical restraints are ordinarily pro-competitive. We believe that these presumptions may be applied improperly in the vertical price fixing area. For example, the Guidelines state, at p. 15:

> . . . limiting the number of distribution outlets may be the most efficient method of insuring the provision of pre-sale demonstration and other informational services that consumers want and that are necessary to effective marketing of a technically complex product. In those circumstances, in the absence of vertical restraints a dealer may invest too little in such services because other dealers that do not provide the services may 'free-ride' on the services that the dealer has provided. By reducing the threat of free-riding, vertical restraints may enable a dealer to capture a significant fraction of the increase in total demand that is generated by his investment

> in informational services and, therefore, encourage dealers to expend the effort required to provide those services.

This statement is a wholesale adoption of the notorious "free-rider" theory as purported justification for all vertical restraints, including price restraints. NMRI submits that the free-rider theory is not supported by empirical evidence and should not serve as the basis for important rules of law.

We are certain the Antitrust Division is aware of a recent report detailed in Computer and Software News (April 2, 1984, copy attached) involving the computer industry. The report indicates that, even for sophisticated computer products, customers most often purchase the product at the store where they receive the initial demonstration. The available evidence shows consumers generally do not avail themselves of services and information from one dealer and purchase from another. We are particularly disturbed by the adoption, without any empirical basis, of the free-rider rationale in the Guidelines because that rationale is frequently asserted in support of relaxation of the *per se* rule with respect to vertical price fixing.

NMRI members firmly believe and their business experience clearly demonstrates that price competition and good service can -- and do -- go hand in hand. For example, S. Robson Walton, an executive of Wal-Mart Stores, who appeared before this Committee in 1983 to protest the Antitrust Division's abdication of enforcement responsibilities, stated (in an interview in Antitrust Law Economic Review, Vol. 14, No. 3 (1982), pg. 85): "Because we [are] an aggressive low margin retailer promoting a manufacturers products backed by other things that go with our stores we don't have the frills but we have a satisfaction-guaranteed policy, refunds without receipts, no questions asked. . . . " In the same series of interviews, Raymond J. Wysocki, Jr., an executive of the Zayre Corporation, stated: "First, in all the years I've been involved in retailing, I've never heard a customer say - nor has such a comment ever been fed back to me - yeah, I went to a specialty store, learned about the product, and then I came here [to a discount store] to buy it."

Further, in distinguishing price from non-price restraints, the Guidelines seem to go beyond existing Supreme Court precedent. For example, the Guidelines state (pp. 36-37) that ". . . if the responsible officials of a firm involved in a vertical restraint adopted it solely to facilitate collusion, that would be strong indication that suppression of competition is the most likely explanation for the restraint. Evidence indicating an apparent anticompetitive purpose must be evaluated carefully, however, because it may merely be an expression of excessive zeal on the part of low-level employees with little ability to influence corporate decisions . . . ." However, to the extent that a "low-level employee" successfully conspires to fix prices, that is anti-competitive activity under existing antitrust law. This is true even if that employee disregards rote corporate instructions on compliance with antitrust law. Statements in the Guidelines to the contrary ought to be removed. They are contrary to settled case law and, indeed, to the Justice Department's own prior enforcement policy. E.g., United States v. Cadillac Overall Supply, Co., 568 F.2d 1078 (5th Cir), cert. denied 437 U.S. 903 (1978) and United States v. Hilton Hotels Corp., 467 F.2d 1000 (9th Civ), cert. denied, 409 U.S. 1125 (1973) (". . . as a general rule a corporation is liable under the Sherman Act for the acts of its agents in the scope of their employment, even though contrary to general corporate policy and expressed instructions to the agents.")

In addition, the Guidelines state (p.11) that ". . . if a supplier adopts a bona fide distribution program embodying both non-price and price restrictions, the Department will analyze the entire program under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies and if the price restraint is merely ancillary to the nonprice restraints." That statement is further demonstration of the Division's intention to erode the rule of law that vertical price maintenance agreements are illegal per se. Under the Division's rule, a price fixing agreement, if accompanied by other restraints, can be defended by "plausible" efficiencies.

Finally, the Guidelines state (p.10) that "Thus, if a supplier adopts a bona fide distribution program embodying nonprice restraints, these Guidelines will apply unless there is direct or circumstantial evidence (other than effects on price) establishing an explicit agreement as to the specific prices at which goods or services would be resold." This appears to be an astonishing restatement of the law on what is a "price-fixing" agreement. Frankly, we do not understand the basis for this statement.

3. The Guidelines impose excessive burdens of proof on terminated distributors.

The Guidelines, as a practical matter, seek to make it virtually impossible for a terminated distributor to challenge a manufacturer for wrongful termination. One can imagine months of computer time dedicated to the elaborate statistical inquiries demanded by the Guidelines. In brief, the Guidelines require the terminated plaintiff to prove, at a minimum, (a) market definition, (b) market shares for all suppliers and all sellers in that market, (c) whether or not other actors in the market engage in "very similar" practices, (d) the ease of entry into both the supplier and retailer markets, (e) the history of the restraint, and (f) the homogeniety of the product. It took the Division two years to fashion these Guidelines -- it could conceivably take a plaintiff two years to fashion an antitrust complaint in compliance with the Guidelines.

PROCESS RELATED CONCERNS

Second, we are also concerned with the process by which the Guidelines were developed. It is difficult for us to understand why Guidelines promoting vertical restraints were necessary. With respect to both price and non-price restraints, Congress and the Courts have, on numerous occasions, provided clear guidelines for the Department of Justice and Federal Trade Commission to use in their law enforcement activities. A statement in the first paragraph of the Guidelines reads: "These Guidelines explain the enforcement policy of the U.S. Department of Justice ("Department") concerning non-price vertical restraints". The use of the word "enforcement" appears to be in error because the rest of the Guidelines specifically deal with the promotion of vertical restraints.

Notwithstanding the "promotional" tones of the Guidelines, it is very difficult to understand why the Department of Justice would not seek comments from all interested parties, including the retailing industry. This is especially true for NMRI since the Department has knowledge of our keen interest in this issue. Along with other interested parties, we met with the Division in 1982. We have corresponded with the Division since then.We filed a brief in the Monsanto case. We have testified before Congress. We have met with Congressional staff and generally participated in this issue since 1982. It is unfortunate and puzzling that we were not given the opportunity to discuss our concerns with the Department of Justice prior to the issuance of the Guidelines. We believe that our industry, which the Department knew would be affected substantially by the Guidelines, should have been heard on this issue.

In December, 1984, NMRI learned from a published report that the Department of Justice was soliciting comments and reworking specific language for their guidelines on non-price vertical distribution restraints. According to the report, the draft guidelines were being made available for review by private attorneys and "scholars".

On December 20, 1984, in response to this report, NMRI wrote to the Justice Department and offered to provide information and comments on the draft guidelines since it was obvious that they would have a significant impact on the retailing industry. As stated in our December 20th letter (copy attached), it was our opinion the guideline drafters would have benefited from the views of discount retailers in fashioning the Division's recommendations.

Unfortunately, the Department did not agree with us. The Department declined our offer and in a letter (copy attached) to NMRI assured that ". . . we have taken full account of the views of all interested parties in developing the Guide -- including the views of the discount retail community".

On January 23, 1985, the Department of Justice issued its new Guidelines. Needless to say, the Guidelines did not, in our opinion, reflect or take into account, the views of the discount retail industry.

After reviewing the Guidelines, NMRI wrote to Mr. McGrath on February 8, 1985 (copy attached), setting out its specific concerns with the new Guidelines. NMRI also disagreed emphatically that the Guidelines reflected, in any way, the views of the discount retail community. Moreover, we indicated that the Guidelines as written did, in our opinion, have an adverse impact on the discount retailing industry and competition in the marketplace. On February 22, 1985, Mr. McGrath responded to our concerns in a six sentence letter (copy attached) confirming ". . . that the approach adopted by the Guidelines is the correct one".

It is distressing that the Department of Justice, whose primary responsibility is to enforce the antitrust laws, now seeks to modify laws and spend significant resources defending and promoting certain restraints of trade rather than actively prosecuting anti-competitive conduct. We thought this matter had been resolved clearly by Congress over the past four years, particularly by the rider in 1983 Appropriations Bill and the language in the 1984 Appropriations Report.

For obvious reasons, we are very concerned with the new Guidelines. We believe that, at a minimum, clarification of the Guidelines is necessary to assure that longstanding Congressional Antitrust policies are not being compromised by a modification of the law by Department of Justice Officials. We urge Congress to direct the Antitrust Division to withdraw the Guidelines and not republish them unless (1) the public can comment, and (2) the Guidelines endorse emphatically the *per se* rule against resale price maintenance. We also urge Congress to stop the Antitrust Division from spending resources defending and promoting restraints of trade. Those resources should be spent on vigorous enforcement of the antitrust laws - - the primary responsibility of the Antitrust Division.

National Mass Retailing Institute
[illegible]

Government Relations Office [illegible] Connecticut Avenue N.W. Washington, D.C. 20036 [illegible]

December 20, 1984

The Honorable J. Paul McGrath
Assistant Attorney General
Antitrust Division
The U.S. Department of Justice
Washington, D.C. 20530

Dear Mr. McGrath:

Over the past several years, the National Mass Retailing Institute (NMRI) has worked assiduously to preserve the existing rules of law pertaining to resale price maintenance. As the trade association representing the discount retail industry, we hope that consumers will continue to enjoy access to quality goods at fair prices. We have testified at Congressional hearings, met with you and your predecessor, William Baxter, to discuss vertical price restraints, and have attempted to educate the public on the merits of vigorous price competition, both interbrand and intrabrand.

We are aware that the Antitrust Division is in the process of drafting guidelines on non-price vertical distribution restraints. According to published reports, these draft guidelines have been made available for review by private attorneys and "scholars". Because of our demonstrated interest in the subject of distribution restraints, we offer our services to the Antitrust Division for reviewing the draft guidelines and making comments thereon. In our opinion, the guideline drafters would benefit from the views of prominent discount retailers in fashioning the Division's recommendations.

We hope you will accept our offer of assistance. We assure you that any drafts which you choose to discuss with us will be kept confidential.

Sincerely,

Robert J. Verdisco

Robert J. Verdisco
Vice-President of Government
Relations

RJV/pts

U.S. Department of Justice

Washington, D.C. 20530

Mr. Robert J. Verdisco
Vice-President of Government
Relations
National Mass Retailing Institute
1150 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Verdisco:

On behalf of Assistant Attorney General McGrath, I wish to thank you for your letter of December 20, expressing interest in the Justice Department's Vertical Restraints Guide.

The Guide, which deals only with non-price vertical restraints, will be released in the very near future. Unfortunately, at this time, we are not able to accommodate requests and comments on the Guide. Let me assure you, however, that we have taken full account of the views of all interested parties in developing the Guide--including the views of the discount retail community. We will, of course, be glad to supply you with a copy of the Guide as soon as it is publicly released.

Thank you once again for your interest in the activities of the Justice Department in the vertical restraints area.

Sincerely yours,

Alden F. Abbott
Special Assistant to the
Assistant Attorney General
Antitrust Division

NMRI National Mass Retailing Institute
570 Seventh Avenue, New York, NY 10018 / (212) 354-6600
Richard L. Mesh
President
Government Relations Office: 1901 Pennsylvania Avenue, NW, Washington, DC 20006 / (202) 861-0774

February 8, 1985

The Honorable J. Paul McGrath
Assistant Attorney General
Antitrust Division
United States Department of Justice
Washington, D.C. 20530

Dear Mr. McGrath:

On December 20, 1984, I wrote you to offer the assistance of the National Mass Retailing Institute ("NMRI") in fashioning the Division's Guildelines on Vertical Distribution Restraints. In response, your Special Assistant, Alden F. Abbott, declined our offer of assistance, but assured NMRI "that we have taken full account of the views of all interested parties in developing the Guide - -including the views of the discount retail community." (Copies of correspondence enclosed).

We have reviewed both the November 30, 1984, draft of the Vertical Restraints Guide and the final January 23, 1985, Vertical Restraints Guidelines. We emphatically disagree that the Antitrust Division has taken "full account of the views of all interested parties . . . including the views of the discount retail community." The final Guidelines do not reflect "the views of the discount retail community." We believe that the Division would have benefited from NMRI's comments.

Because we are concerned that our views are not reflected in the Guidelines, we offer some comments for your consideration. We will also make these views known to Congress in order that any Congressional review of the Guidelines will be better informed.

1. The Guidelines fail to emphasize sufficiently the continued validity of the <u>per se prohibition of vertical price fixing.</u>

Throughout the Guidelines, sweeping statements incorrectly suggest that <u>all</u> intrabrand restraints are permissible, and, indeed, encouraged. While there is token reference to the <u>per se</u> rule with repect to resale price maintenance, a reader cannot help but believe that the Antitrust Division hopes eventually to overcome that rule.

For example, one searches in vain in the initial portions of the Guidelines for the recognition that vertical price fixing is illegal <u>per se</u>. The Guidelines' first footnote does acknowledge that resale price maintenance "is not treated" in these Guidelines, but the Antitrust Division fails to take that opportunity to emphasize that the practice is illegal <u>per se</u>. Further, in a discussion of the <u>per se</u> rule generally, at pp. 4-6, you again fail to mention that resale price maintenance is illegal <u>per se</u>. Instead, the Guidelines concentrate on the <u>per se</u> rule in horizontal cases. Not until page 10 do the Guidelines make an off-hand reference to resale price maintenance, and the Guidelines' statement is hardly an endorsement of that rule of law:

> For many years resale price maintenance has been held to be illegal *per se*, and so these guidelines do not apply to resale price maintenance.

In marked contrast to the tepid recognition of the *per se* rule, the Guidelines make overbroad statements on the *legality* and pro-competitiveness of all vertical restraints. For example, Section 3.2., while captioned "*Anticompetitive* Effects of Vertical Restraints", ironically commences with the proposition that ". . . vertical restraints generally have a procompetitive or competitively neutral effect. . ."

Such sweeping statements fail completely to condemn vertical *price* restraints and thereby ignore decades of teaching on the pernicious effects of resale price maintenance. The Antitrust Division, it would appear, sees its role more as defending certain restraints than prosecuting anticompetitive conduct long condemned by Congress, the Courts, and previous Antitrust enforcement officials.

While this is not the occasion to renew our longstanding debate with the Division on the anticompetitive effects of resale price maintenance, we do enclose for your consideration a pamphlet on this subject. In our opinion, this review of Congressional findings and economic arguments clearly supports the *per se* rule.

We believe that by the Guidelines' failure to endorse emphatically the rule of law that resale price maintenance is illegal *per se*, you are inviting manufacturers to consider that practice. Indeed, you seem to invite the repeal of the *per se* rule prohibiting resale price maintenance. It is to that point which we next turn.

2. The Guidelines invite the rejection of the *per se prohibition of price fixing.*

In many instances, the Guidelines rely on unfounded presumptions as support for the proposition that vertical restraints are ordinarily pro-competitive. We believe that these presumptions will improperly be applied in the vertical price fixing area. For example, the Guidelines state, at p. 15:

> . . . limiting the number of distribution outlets may be the most efficient method of insuring the provision of pre-sale demonstration and other informational services that consumers want and that are necessary to effective marketing of a technically complex product. In those circumstances, in the absence of vertical restraints a dealer may invest too little in such services because other dealers that do not provide the services may 'free-ride' on the services that the dealer has provided. By reducing the threat of free-riding, vertical restraints may enable a dealer to capture a significant fraction of the increase in total demand that is generated by his investment in informational services and, therefore, encourage dealers to expend the effort required to provide those services.

This statement is a wholesale adoption of the notorious "free-rider" theory. NMRI submits that the free-rider theory is not supported by empirical evidence and should not serve as the basis for important rules of law.

We are certain you are aware of a recent report involving the computer industry indicating that, even for sophisticated computer products, customers most often purchase the product at the store where they receive the initial demonstration. The available evidence shows that consumers generally do not avail themselves of services and information from one dealer and purchase from another. We are particularly disturbed by the adoption of the free-rider rationale in the Guidelines, without any empirical basis, because, as you know, that rationale is frequently asserted in support of relaxation of the per se rule with respect to vertical price fixing. NMRI members firmly believe and their business experience clearly demonstrates that price competition and good service can -- and do -- go hand in hand. We have assembled substantial evidence on this point and we are prepared, as we were prepared prior to release of the Guidelines, to share this material with you.

Further, in distinguishing price from non-price restraints, the Guidelines seem to go well beyond existing Supreme Court precedent. For example, the Guidelines state (pp. 36-37) that "Evidence indicating an apparent anticompetitive purpose must be evaluated carefully, however, because it may merely be an expression of excessive zeal on the part of low-level employees with little ability to influence corporate decisions. . ." To the extent that a "low level employee" successfully instructs a distributor that, if it does not comply with a manufacturer's suggested price, it will be cut off, that is price fixing. That employee has influenced a seller's price conduct. And even if that employee disregards rote corporate intructions on compliance with the antitrust law, the employee has caused the fixing of prices. Statements in the Guidelines to the contrary ought to be removed.

In addition, the Guidelines state (p.11) that "if a supplier adopts a bona fide distribution program embodying both nonprice and price restrictions, the Department will analyze the entire program under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies and if the price restraint is merely ancillary to the nonprice restraints." That statement is further demonstration of the Division's intention to erode the rule of law that vertical price maintenance agreements are illegal per se. Under that rule, a price fixing agreement, if accompanied by other restraints, can be defended by "plausible" efficiencies.

Similarly, the Guidelines appear to reject the significance of effects on price in determining whether there is a price fixing agreement. Under the Gypsum case (United States v. United States Gypsum Co., 438 U.S. 422 (1978), if parties engage in conduct knowing the consequences of that conduct, they can be held to have intended that effect. Thus, if parties enter into an agreement, knowing that prices will be fixed as a result, the parties can be thought to have adopted a price fixing agreement. To the extent your Guidelines seek to avoid this established rule of law, they are improper.

3. The Guidelines impose excessive burdens of proof on terminated distributors.

The Guidelines, as a practical matter, seek to make it virtually impossible for a terminated distributor to challenge a manufacturer for wrongful termination. One can imagine months of computer time dedicated to the elaborate statistical inquiries demanded by the Guidelines. In brief, the Guidelines require the terminated plaintiff to prove (a) market definition, (b) market shares for all suppliers and all sellers in that market, (c) whether or not other actors in the market engage in "very similar" practices, (d) the ease of entry into both the supplier and retailer markets, (e) the history of the restraint, and (f) the homogeniety of the product. Please recall that it took the Division two years to fashion these Guidelines -- it could conceivably take a plaintiff two years to fashion an antitrust complaint in compliance with your Guidelines.

This simply is our initial reaction to the Guidelines. We have assembled a wealth of material on the subject and, as we have indicated repeatedly, we would be delighted to share our thoughts and materials with you and your staff. We urge the Antitrust Division to clarify the Vertical Restraints Guidelines until they reflect the present state of the law: resale price maintenance is illegal *per se*; a resale price maintenance agreement may be proven by circumstantial evidence, including evidence on the foreseeable *effects* of adopting a restraint; and the free-rider rationale is merely a theory, without empirical basis.

Thank you for your attention to our views.

Sincerely,

Robert J. Verdisco

Robert J. Verdisco
Vice-President for
Government Relations

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enclosures

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

FEB 22 1985

Mr. Robert J. Verdisco
Vice-President for
Government Relations
National Mass Retailing Institute
1901 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Dear Mr. Verdisco:

Thank you very much for your letter of February 8, 1985, setting forth comments on the Justice Department's Vertical Restraints Guidelines. I wish to assure you that in drafting the Guidelines we carefully considered the full spectrum of views on vertical restraints issues. We fully respect your reservations about certain provisions in the Guidelines. Nevertheless, we firmly believe that the approach adopted by the Guidelines is the correct one. We hope that the Guidelines will help reduce the uncertainty associated with the antitrust analysis of vertical restraints, and thereby assist business planning and encourage the use of lawful vertical practices.

Thank you once again for your expression of interest in the Justice Department's vertical restraints enforcement policy.

Sincerely,

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Computer + Software News, April 2, 1984 22

Consumers buy where they shop

NEW YORK—If there is one widely held misconception about the home computer market debunked by the *C+SN*/SRI Research Center survey, it is that shoppers exploit the information and sales assistance available at specialty stores before actually buying where the price is right.

Apple topsiders agree. "Our studies found that consumers tend to buy in the same type of outlet where they shopped for a computer," outgoing worldwide sales and marketing exec vp Floyd Kvamme told *C+SN* recently.

Nearly 30% of all home computer owners told SRI pollsters that they shopped for a home computer in a specialty store and an almost identical 28% reported actually buying in a specialty store.

With the exception of consumer electronics stores—where 20% of the consumers shopped but only 12% actually bought—and Sears (where the nation's largest retailer could transform only 1 of every 8 customers into a sale), *C+SN*'s statistics bear out Kvamme's contention for all other types of outlets.

This finding carries tremendous implications for margin-squeezed specialty stores. It suggests they should pay less attention to the pricing structure of low-margin mass merchants than to the policies of competitors within their own tier of the industry.

For while 1 of every 2 computer owners selected the store they bought the unit in because of price, it appears they comparison shopped between similar types of stores. And with nearly 1 of every 8 consumers who expect to be in the market for a home computer in the next six months mentioning a computer specialty store as the place they expect to buy, this could spell sizable plus-profits for dealers. ●

Senator METZENBAUM. Mr. Chairman, as I had indicated to you, I promised to do a program with Senator Hatch at 12:00, and I am going to have to excuse myself. But Dr. Huntley and Mr. Stevenson, am I correct in my understanding before I leave, that the testimony of both of you is generally along the same lines as the two previous witnesses, indicating a concern about the guidelines and indicating support for the Supreme Court decision as compared to the guidelines?

Mr. STEVENSON. That is correct, Senator.

Dr. HUNTLEY. Yes, Senator.

Senator METZENBAUM. That what you are really saying is that if free competition is to prevail, the guidelines stand in the way of free competition working in this country; is that a fair statement?

Dr. HUNTLEY. Yes.

Mr. STEVENSON. True.

Senator METZENBAUM. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Dr. Huntley, we will be glad to hear from you, and we are glad to have you here.

Dr. HUNTLEY. Thank you, Senator. I am glad to be here.

I certainly will not read from my written statement and ask that it be included in the record, if that is acceptable.

The CHAIRMAN. Without objection, that will be done.

Dr. HUNTLEY. And I will just speak from a few notes, and do so in well less than five minutes. The concern that we express—I represent the National Association of Catalogue Showroom Merchandisers, and I am President of Best Products, which is a $2,250,000,000 discount retailer, doing business through 240 outlets in 30 States.

The CHAIRMAN. Down our way, you operate under "Roses", I believe, don't you?

Dr. HUNTLEY. No, sir. That is somebody else.

The CHAIRMAN. Oh, that is Mr. Jelin. Excuse me.

Dr. HUNTLEY. Our concern, I think, has been touched on by the previous witnesses in almost all cases. My concern primarily, I think, could be stated in three or four very simple categories, I hope maybe in less than a minute and a half. One, the casual attitude which these guidelines display toward retail price maintenance. That casual attitude has been spoken to eloquently by several prior witnesses. The specific language in the guidelines that limits the per se rules to explicit agreements—not a rule found in the Supreme Court decisions that I am familiar with. And furthermore, even explicit agreements would not be illegal if they are accompanied by other restraints, producing the rather bizarre rule that the more restraints there are, the less illegal they are likely to be.

A second concern, moving on from resale price maintenance, is the relaxed attitude of the guidelines generally toward vertical restraints, toward other forms of vertical restraints. For example, in 4.226 of the guidelines, the language which tends to indicate that since justifications for vertical restraints may be hard to show, such justifications will tend to be presumed. And in the absence of a contrary showing, it will be assumed they are available. That could easily be inferred from some of the language in the guidelines, somewhat of a reversal of the attitude that it seems to me the courts have generally taken.

Even tying arrangements, traditionally thought of as anathema to antitrust policymakers, come in for words of praise in the guidelines. They are described in the guidelines, for example, as policies that "protect the integrity or reputation of a product"—that is a quote—the same kind of language that was utilized to justify resale price maintenance going back into the Thirties.

Furthermore, tying arrangements are regarded by the guidelines as "redistributing risk"—that is a quote—by using—this is not a quote, but a paraphrase—by using sales and profit strength of one product to lever into the marketplace another product. This is described in the guidelines as "risk-sharing efficiency"—a euphemism that would hardly have passed antitrust policy of the kind that I am familiar with.

The third area of concern to me is the guidelines' apparent quest for simplicity via a market analysis comparable to that used in merger cases. Such an analysis of markets and market power is in fact quite complex and often illusory, as merger cases themselves reveal. For in my opinion, the quest for this kind of simplicity would, I project, fail, and would result in another form of simplicity, namely, the per se legality of all vertical restraints except for naked, unadorned, explicit resale price agreements, and even those would be legal if they are couched with other restraints.

My view would simply be that if such a revising of the present law is to occur—and I desperately hope it will not—if it is to occur, it should certainly be done by legislation and not by enforcement guidelines. The earlier witness for the Justice Department noted just this morning—and these are his words, quoted to you within the last 45 minutes—these guidelines are "an attempt to form legal rules". Those were his words earlier this morning. I would suggest that it is inappropriate for the Justice Department through guidelines to "attempt to form legal rules".

I think it was Justice Cardozo who said, "The law never is. It is always about to be." If the Justice Department has its way, we can see fairly clearly what the law is about to be.

That is my statement, Senator, and I appreciate the opportunity to be here.

The CHAIRMAN. Thank you.

[Statement follows:]

WRITTEN STATEMENT SUBMITTED TO
THE UNITED STATES SENATE JUDICIARY COMMITTEE

NATIONAL ASSOCIATION OF CATALOG SHOWROOM MERCHANDISERS

By: Dr. Robert E. R. Huntley *
President
Best Products Co., Inc.

On behalf of the National Association of Catalog Showroom Merchandisers ("NACSM"), we welcome the opportunity to express our grave concern with recent efforts to impose manufacturer restraints throughout the economic channels of distribution.

Ten years ago NACSM and Best Products testified before this Committee and urged repeal of resale price maintenance laws; the Congress did so.

The record of those hearings showed higher consumer prices of up 20 to 40 percent for products where the manufacturer controlled the price. We regrettably report that the condition again exists. But today it is no longer called retail price fixing, but rather "vertical restraints by firms operating at different levels of the distribution chain."

The Justice Department Vertical Restraint Guidelines of January 25, 1985 promote manufacturer restrictions on price and product availability. Virtually all observers, except the Department, recognize that the Guidelines are contrary to seventy years of judicial precedent and the clear legislative intent to continue retail price fixing as <u>per se</u> unlawful.

The Guidelines do not reflect the existing law, yet the stated purpose of this "enforcement" policy is to effect the law. If they succeed it will create a network of private

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* Robert Huntley is the President of Best Products Company, Inc., one of the nation's largest discount retailers, headquartered in Richmond, Virginia with 245 stores in over 30 states doing approximately 2.25 billion in annual sales. Dr. Huntley was the President of Washington & Lee University from 1968 until 1983 and taught antitrust and trade regulation at the Washington & Lee Law School, before and after his presidency. Best Products is a member of NACSM which represents 150 catalog showroom companies with 2,500 retail stores in all fifty states, doing an estimated $10 billion in annual sales.

regulations and conditions, continuing long after point of sale, that we perceive as a great threat to the efficient American distribution of goods.

For example, one Japanesse audio manufacturer terminated catalog showrooms and other discount retailers as "authorized dealers" and sent a written notice of January 15, 1984 to all of its distributors requiring "pre-clearance" of all customers.

On January 1, 1985 a dealer of Japanesse produced televisions announced by a self described "Very Important" written notice that beginning February 1, 1985 it would "refuse to sell to any dealer whom (it) determined has sold or offered for sale the product at less than the suggested minimum list prices".

A maker of a very popular doll is now telling catalog showroom companies that a large retailer has complained about low retail prices and "requests" adherence to a minimum price to avoid "delivery problems".

Catalog showrooms, as discount retailers, see watchmakers, audio and electronic manufacturers, fragrance bottlers, crystal and china sellers, and doll and apparel makers etc. attempting to:

1. dictate the price and terms of resale to our customers; or
2. to keep the product from us as "price cutters".

The escalation of these blatant attempts to control price and product can be traced to escalating statements emanating from the U.S. Department of Justice in recent years which promote retail price fixing by manufacturers.

We believe anyone competing in the real world of retail merchandising knows that there are great differences in efficencies between merchants. We believe this country should encourage these retailers to compete by lowering their costs, and their prices to consumers.

The Subject Is Retail Price Fixing:

The most outrageous example, in our view is the Vertical Restraint Guidelines issue by the Department on January 25, 1985 purportedly to deal only with nonprice vertical restraints (footnote 1); however all commentators, outside of the Department, recognize the contrary is true.

For example at Section 2.3 the Guidelines state:

> "All vertical restraints however, ... may have some effect on price. Therefore it is important to avoid characterizing a particular restraint as resale price maintenance merely because it may have an effect on price."

As the U.S. Supreme Court has said in Continental T.V. v. G.T.E. Sylvania, 433 U.S. 36 (1977): "Furthermore, Congress recently" has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair-trade pricing at the option of the individual States. Consumer Goods Pricing Act of 1975; supra at p. 52, n. 18.

In the much discussed G.T.E. Sulvania case, the Supreme Court has made it clear that price restraints remain *per se* unlawful.

> "As in Schwinn, we are concerned here only with nonprice vertical restrictions. The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As Mr. Justice White notes, some commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in White Motor Co. v. United States, Mr. Justice Brennan noted that, unlike nonprice restrictions, "resale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the offered product, but quite as much between that product and competing brands."

The Justice Department Appropriation Act was passed and signed into law by President Reagan in November 1983, S. Joint Res. 105; 98th (Congress, 1st Session (1983)) H.R. Res. No. 2912, which law specifically provided that no funds be expended by the Justice Department to attempt to overturn the per se illegality of retail price fixing for 1983/4.

The United States Supreme Court again upheld the per se illegality of retail price fixing by manufacturers in Monsanto v. Spray-Rite 104 S. Ct. 1464 rehearing denied 104 S. Ct. 2378 (1984).

In report language the Justice Department Appropriation Act of 1984 again specifically directed the Department of Justice not to expend any funds to overturn the per se illegality of retail price fixing for 1984/5. Nevertheless the Guidelines were issued, which we respectfully suggest were in contravention of those acts.

No Public Notice:

A draft of the Justice Guidelines dated November 30, 1984 was circulated by Department Staff to a select number of attorneys. Despite their request to do so, neither the Congress nor the discount retail industry was provided an opportunity to comment.

The discount retail industry and some members of Congress learned of the existence of the Guidelines and requested an opportunity to comment. The Guidelines were then promptly issued in "final" form, and even more blatantly promoted retail price fixing than the earlier draft.

Foreign Competition:

The Vertical Restraint Guidelines provide rigid manufacturer control over retailers. They are particularly naive in failing to consider that many U.S. consumer product manufacturers attempt to achieve above-competitive prices in the U.S. market through the exclusion of parallel imports, which they term as "gray market" goods.

Indeed, in earlier proceedings of a case pending before the U.S. Supreme Court commonly referred to as the "Japanese Electronics Case", Matsushita Elec. Indust., et al. v. Zenith Radio, certiorari granted April 1, 1985 the Third Circuit Court of Appeals found that foreign television manufacturers set prices in Tokyo in order to dominate the U.S. television market.

What the Justice Department says in its Guidelines, however, is:

> "2.3 Distinguishing Between Price and Nonprice Restraints.
>
> For many years resale price maintenance has been held to be illegal per se, and so these Guidelines do not apply to resale price maintenance. All vertical restraints, however, even those that result in substantial procompetitive benefits, may have some effect on price. Therefore, it is important to avoid characterizing a particular restraint as resale price maintenance merely because it may have an effect on price. Before characterizing a practice as a price restraint subject to per se condemnation, there must be an agreement between a supplier and its distributors as to resale prices. Thus, if a supplier adopts a bona fide distribution program embodying nonprice restraints, these Guidelines will apply unless there is direct or circumstantial evidence (other than effects on price) establishing an explicit agreement as to the specific prices at which goods or services would be resold".

Manufacturers Can Control The Economy:

The leading economist of the Chicago School of Economics, George Stigler, in his Nobel Prize winning work*, lays as the foundation of the theory of competitive prices that they are characterized by two main properties--the property of clearing markets by distributing existing supplies efficiently, and the property of equalizing returns to resources to direct production efficiency.

Implicit in the Department's 46 pages of ratio analysis is the unproven but critical assumption that retailers (discount or otherwise) have no say in the marketplace, and are incapable of competing vis a vis manufacturers. There are several interrelated aspects to the economic foundation of this resale price maintenance. To the extent competing manufacturers have price control over their respective chains of distribution, the opportunity for parallel action or horizontal collaboration among the manufacturers concerning prices charged throughout the industry is enhanced. Without such control, manufacturers lack the power to enter into such

* The Organization of Industry. George J. Stigler University of Chicago Press - 1983, page 9.

agreements, and absent such agreements manufacturers must stimulate distributors to sell their products.

Where interbrand competition is not particularly vigorous, or where a particular brand has unique features desired by consumers, it is often the high margin retailers more than the manufacturer who have the most to gain by a resale price maintenance program. Such a program eliminates their main source of price competition: other dealers of the same brand. Thus, retailers often attempt to use their power to coerce suppliers into establishing and enforcing a resale price maintenance program, all to the benefit of the "authorized" dealers. The bulk of the cases cited in the fair trade hearings, and our experience, confirms that most such activities involve retail distribution of consumer products. A great many of these products require no sophisticated services whatsoever.

Resale price maintenance and other vertical restraints "bribe" particular retailers to "push" a certain manufacturers product (over a competitors) onto an unsuspecting public because of the higher "above competitive" margin. This is hardly an economic goal to be encouraged by the United States government.

Conclusion:

These Guidelines reflect a low opinion of consumer freedom of choice, discount retailers, the judiciary, and the Congress, using concentration ratios and unsupported economic assumptions to permit the impermissible. The question at hand is whether the staff of a government agency can be permitted to reverse 70 years of legislative and judicial history by the arbitrary use of such questionable assumptions, not related to the actualities of the market place.

As Congressman Hamilton Fish stated in introducing House Congressional Resolution 128: "When the Vertical Guidelines are demonstrably in error, therefore, it is the duty of the Congress to declare that such is the case".

We respectfully urge the Senate to join with the House Resolution indicating the sense of the Congress, that the Justice Department Guidelines do not reflect the law of the land.

51-657 0 - 85 - 6

RESPONSE OF DR. ROBERT E.R. HUNTLEY, PRESIDENT OF BEST PRODUCTS CO.,INC. ASHLAND, VIRGINIA ON BEHALF OF THE NATIONAL ASSOCIATION OF CATALOG SHOWROOM MERCHANDISERS (NACSM)

AUGUST 13, 1985

QUESTIONS FOR BUSINESS PANEL

QUESTION #1:

Why do you feel you need a congressional resolution concerning the vertical restraint guidelines?

RESPONSE:

Virtually all discount retailers, the catalog showroom industry and Best Products wish to express their appreciation to the Committee for the opportunity, in the public interest, to apprise you of our conviction that, absent passage of a joint Congressional Resolution unequivocally disavowing the Vertical Restraints Guidelines issued by the U.S. Department of Justice on January 23, 1985, there will be a substantial adverse impact on price competition for consumer goods in the U.S. marketplace.

QUESTION #2:

How do vertical restraints affect consumers?

RESPONSE:

Steps have already been taken by many manufacturers toward the elimination of retail price competition and we believe that the Justice Department Guidelines will provide a major impetus toward increasing selling prices to consumers by billions of dollars per year.

In order to achieve price stability among competing retailers, manufacturers need obtain sufficent control over distribution of the product after they sell it, to be able to discipline and if necessary terminate price cutting retailers. As a corollary to such schemes it is essential to keep those products for which retail prices are being fixed from discount retailers, who by definition sell for less than full margin retailers.

Catalog showroom companies, for example, installed sound rooms in their facilities and met other criteria set by a dominant Japanesse audio equipment manufacturer and became authorized dealers. After recent statements and acts by federal antitrust officials encouraging resale price maintenance, this same manufacturer actually complained to the federal government about retail price competition and terminated discount retailers, including virtually the entire catalog showroom industry.

We respectfully refer the Committee to my testimony of July 16, 1985, as well as the testimony of Andrew Lewis, Chairman of the Board of Best Products, before the U.S. House of Representatives in Febuary, 1984 (copy enclosed) which refer to specific examples of the accelerating trend to restrict the free flow of goods and unnecessarily raise the prices of many products for consumers.

<u>QUESTION # 3:</u>

Chicago school theorists claim that these restraints on retail competition are necessary so that consumers get desired point-of-sale services, clean showrooms, good advertising, etc. Do you agree?

<u>RESPONSE:</u>

The suggestion that vertical restraints are necessary to prevent "free riding" by discount retailers, who it is claimed fail to provide necessary services, is contrary to the direct practice of the marketplace. Catalog showrooms provide similar services to their competitors. Furthermore, the suggestion displays a pronounced lack of familiarity with the marketplace, and appears to rest entirely on economic theory based upon "reading the available literature", as the Justice Department testified at the hearings on July 16, 1985.

One need only refer to the testimony of Mr. Lewis or myself referred to above, or to the Hearings before this Committee in February 1975, concerning S.408 (Repeal of the Federal Fair Trade Laws) to demonstrate that it is those who wish to fix prices that seek to restrict product availability.

We enclose a study prepared for NACSM by Professor H. Michael Mann, former Chairman of the Federal Trade Commission Bureau of Economics in the early 1970's (previously submitted to the House Judiciary Committee) which concludes that "it hardly seems sensible to tolerate a practice conducive to promoting structural conditions that are monopolistic. This is particularly so when the costs of RPM to the consumer in prices paid have been so well documented."

There is at least one difference of opinion however. As noted on page 4 of my testimony the Vertical Restraint Guidelines states:

> "All vertical restraints however, ... may have some effect on price. Therefore it is important to avoid characterizing a particular restraint as resale price maintenance merely because it may have an effect on price."

<u>QUESTION #4:</u>

Throughout the years, we have seen innovations in retailing like supermarkets, discount stores, factory outlets, catalog showrooms, all virgorously opposed by existing retail merchants. If these vertical guidelines succeed in encouraging widespread restrictions, what effect will this have on retail competition and new innovations that benefit the consumer?

RESPONSE:

As Robert Steiner noted in Vertical Restraints and Economic Efficiency, F.T.C. Working Paper No. 66, June, 1982, price competition is most workable at the retail level because there are so many competitors.*

To the extent competing manufacturers have price control over their respective chains of distribution, the opportunity for horizontal collaboration among the manufacturers, concerning prices charged throughout the industry, is enhanced. Without such control, the manufacturers lack the power to enter into such agreements. In the absence of such restrictions, it is in the obvious interest of each respective manufacturer to stimulate its own distributors to compete vigorously with the distributors of other brands (interbrand competition).

Resale price maintenance is also used to protect distributors of the same brand from competition with each other (intrabrand competition). Resale price maintenance could be forced on unwilling wholesalers or retailers by a dominant manufacturer. In truth, however, where competition for a product is not particularly vigorous, or where a particular brand has strong advertising and/or features desired by consumers, it is often the high margin retailers, more than the manufacturer who push for resale price maintenance. Such a program eliminates their main source of price competition: fellow dealers of the same brand of consumer products.

Lastly, resale price maintenance and other vertical restraints conceded by the Department to effect price are really aimed at "bribing" particular retailers to "push" their product (over a competitors) onto an unsuspecting public because of the higher (above competitive) margin. This is hardly an economic goal to be encouraged by the United States Government.

*Footnote:
For an excellent analysis of the problem - see Basic Relationships in Consumer Goods Industries, Part XIII, by Robert S. Steiner Research in Marketing Magazine - January 1984, see also Gerhart, The "Competitive Advantages" Explanation for Interbrand Restraints: An Antitrust Analysis, 3 Duke L.J. 417,431 (1981).

We believe that catalog showroom stores, off price stores and retailing innovations still to come will be stifled if the purposes and effects of the Vertical Restraint Guidelines are carried to their fruition.

QUESTION # 5:

Have you ever been denied the ability to sell a product because of pressure placed on the manufacturer or wholesaler by your high-priced competitors? Please explain.

RESPONSE:

Yes, the catalog showroom industry has experienced the pressure exerted by high margin retailers and suppliers to terminate, or refuse to sell to them. Please see the responses to the above questions for references to specific examples of RPM of particular product lines.

QUESTION # 6:

What effect does the *Monsanto* case have on your ability to sue when victimized by price fixing conspiracies?

RESPONSE:

As I testified, the *Monsanto* decision increases the already weighty burden upon a plaintiff to prove an antitrust violation, and we support Congressional efforts to alleviate this problem. However, it is our opinion that the Vertical Restraint Guidelines are far more damaging and potentially invidious to the free flow of merchandise in that, if they were to become the framework of our free enterprise system, they would provide for a maze of self regulatory schemes by manufacturers tying up the American economic channels of distribution.

WRITTEN STATEMENT TO

THE UNITED STATES HOUSE OF REPRESENTATIVES

Subcommittee on Commerce, Transportation and Tourism

ANDREW LEWIS, PRESIDENT BEST PRODUCTS CO., INC.
On behalf of

NATIONAL ASSOCIATION OF CATALOG SHOWROOM MERCHANDISERS

February 1984
Washington, DC

We appreciate the opportunity to apprise the Committee of our view of Federal Trade Commission enforcement activities with respect to resale price maintenance. We believe such practices do not serve desirable economic ends.

Best Products operates 197 stores in 27 states, and did approximately $2 billion in sales in 1983. It is part of the catalog showroom industry which is represented by the National Association of Catalog Showrooms Merchandisers.

NACSM represents 150 companies with 2,000 retail stores in all fifty states doing an estimated $10 billion in annual sales.

POSITIVE F.T.C. ACTIVITIES

The catalog showroom industry recognizes the difficulties a federal agency faces in attempting to regulate commercial practices in a manner that prevent abuses, but does not hinder competitive activity in the marketplace. We wish particularly to acknowledge recent attempts by the Commission to broaden permissible substantiation of advertising claims. Since we disseminate advertisements on a national basis, we recognize the particular advantages of nationwide advertising standards that do not unnecessarily hinder the free flow of as much information as possible to the consumer, which we believe requires a "reasonable man or woman" standard. Indeed, we believe this trend is fully supported by recent decisions of the United States Supreme Court.

Catalog showrooms provide essentially the same products and services and transmit essentially the same information to their customers as other retailers. However, we do so at a lower price to the consumer than do many full margin retailers. For the record today, we wish to focus on the resurrection by some manufacturers of retail price fixing, and attempts to prevent the distribution of products to retail "price cutters."

Statements and actions during the past two years by both federal agencies charged with enforcing the antitrust laws have, in our opinion, promoted such retail price fixing.

By and large, we believe the Commission has not acted in the public interest in modifying a series of consent orders outstanding against manufacturers who had previously been found to be promoting resale price maintenance.

F.T.C. CONSENT ORDERS

For example, the Lenox Corporation petitioned the F.T.C. to modify a consent order to allow it to terminate "trans-shippers" of its chinaware. Best Products and NACSM each submitted papers and evidence in opposition to what we saw as a direct attempt to cut off the source of the product to "price cutting" retailers such as those in our industry. We pointed to the affidavits submitted by Lenox complaining of the low prices charged consumers by some discount retailers including catalog showrooms. Nevertheless, the F.T.C. granted the petition.

We might ask: Why would anyone want to promote this practice? We believe it can only be explained by an "over appreciation" for bigness "per se." Indeed, retail price fixing by a manufacturer can permeate an entire industry, as other manufacturers, finding they are at a competitive disadvantage, will adopt programs similar to those now common in the audio equipment industry.

Prior to the Lenox petition, the F.T.C. had granted the petition of a smaller audio speaker manufacturer, J.B. Lansing Company, to modify its consent order to permit it to control distribution of its product. Best Products had filed an opposition to that petition. The F.T.C. nevertheless granted it and opened the "floodgates."

Next, Pioneer Electronics Corp., a large Japanese manufacturer of audio equipment, which was a dominant force in the American consumer audio market, filed a similar petition. NACSM and Best Products each filed lengthy briefs and evidence in opposition. We pointed out that catalog showrooms had been authorized Pioneer dealers that had set up separate soundrooms, hired trained personnel, and provided services at least equal to its retail competitors; yet Pioneer terminated all dealer agreements with the industry "without cause."

Pioneer, in its petition to the Federal Trade Commission, complained of "free riding retailers" who sold for less, and who allegedly might not provide necessary services. NACSM informed the Commission that catalog showrooms sold Pioneer products for less (as we do all products) and provide all services and amenities. The Federal Trade Commission, in this case, agreed and so modified the prior consent order so that there could be "objective standards." Catalog showrooms can meet those standards. This should have been sufficient, but it was not.

Next, Sansui, another audio equipment manufacturer, petitioned the F.T.C. to modify its consent order. NACSM and Best Products both filed papers in opposition pointing out:

(1) The "galloping" trend in the entire consumer audio equipment industry toward price stabilization. We pointed out that even William Baxter, the head of the Antitrust Division of the Justice Department and one of the strongest proponents of resale price maintenance, conceded that if an entire industry began to adopt such "RPM" that it would be necessary to step in and break up the price fixing cartel that had so recently been promoted by the United States Government.

(2) That the last audio manufacturer to have its consent order modified, Pioneer, had immediately thereafter announced to its wholesalers that they had to obtain

"pre-clearance" for all customers. That is, wholesalers must have prior authorization from Pioneer to sell to discounters such as catalog showrooms. A wholesaler, who wants to keep his authorized dealership, is less than anxious to tell Pioneer that it wants to sell to companies which Pioneer deliberately cut off a year and a half ago. There is the obvious "chilling effect" on competition.

The F.T.C. granted the application of Sansui, noting that it had already granted a number of other such applications in the audio industry. Indeed, it was soon followed by the petition of another audio manufacturer, Magnavox. In our opinion, this ensures that discount prices will not exist for many buyers of stereos, tape deck, and other sound equipment.

The F.T.C. continued this trend in modifying another consent order last month thereby allowing the Bulova Watch Company to terminate "trans-shippers," that is those distributors which sell to discount retailers such as catalog showrooms.

As we have demonstrated, both Best Products and NACSM have gone to the F.T.C. again and again to state our position on resale price maintenance, and to demonstrate the effects that current F.T.C. policy in this area has on free market competition. Two Commissioners, Michael Pertschuk and Patricia Bailey have agreed with us, but in the final analysis, the F.T.C. has been in opposition to our position.

We believe "retail price maintenance" despite its obvious adverse impact on retailers who are denied access to product lines, is also aimed directly at the viability of discount prices, and it is axiomatic that if all retailers must charge the same price for a product, it will cost more than in a free marketplace. There is ample evidence that retail prices in such cases are up to forty percent (40%) higher than when "retail price maintenance" does not exist.

Why eliminate a price option for consumers when it benefits no one except price fixers?

THE COST TO CONSUMER

When Best Products and NACSM both testified before the U.S. Senate in 1975 in support of the repeal of fair trade, we pointed out that there were price differentials of up to 40% on fair traded products vs. prices without fair trade. Similar price differentials exist today.

We have previously mentioned products such as Lenox china and Pioneer audio equipment which manufacturers seek to keep out of the hands of catalog showrooms and other discount retailers with the purpose and effect of maintaining higher retail prices for the consumer.

We might also give examples of watch manufacturers and crystal and chinaware manufacturers, such as, and in particular, Seiko Watch Company.

The Seiko Company prints an international catalog in Japan which lists the many hundreds of watches it sells worldwide. From that large catalog United States purchasers can select watches that they believe are desirable for the United States market, and the Seiko United States affiliated marketing company will then put those watches in its domestic (i.e., American) catalog. However, the profit margin of the United States marketing affiliate, Seiko U.S.A., and/or the profit margin provided to full margin retailers is assured at such a high level that it makes it profitable to purchase identical watches from overseas and import them into the United States and sell them at catalog showrooms and other discount retailers at prices often up to 40% less than the prices for watches purchased from Seiko's U.S. affiliate. It is clear to us that the consumer is well served by permitting free and open competition, rather than allowing the United States to become an island of high prices in an otherwise worldwide sea of competitive prices.

Seiko, a Japanese manufacturer like Pioneer, after capturing a major portion of the product market, has recently taken a variety of steps to keep its product out of the hands of catalog showrooms and other discount retailers. First, it began an authorized dealer advertising program in both the trade journals, and in the consumer mass media. In advertisements, it suggested that purchasing a Seiko watch from a "non-authorized dealer" presented a variety of problems and possibly an inferior product, with lack of service, etc., all of which we believe is essentially untrue. In addition, Seiko has attempted to utilize various legal procedures to prevent, or at least to discourage the sale of its watches by discounters. Most recently, Seiko has been at the forefront of a group of foreign manufacturers seeking to change United States Customs Department regulations* to allow foreign manufacturers to prevent importation of their product by United States importers and retailers. While not directly attributable to F.T.C. enforcement action, we believe the whole climate of an encouragement of resale price maintenance has encouraged such efforts, to the point that, as this Committee knows, the Congress found it necessary in November of 1983 to pass an Appropriation Bill that specifically provided that the Justice Department and other federal agencies (i.e., F.T.C.) may not expend funds to promote resale price maintenance or a change in the per se rule.

The Attorney General of Connecticut has just obtained a consent order prohibiting the local Seiko distributor from fixing retail prices. The Attorney General of Missouri recently obtained a similar consent order from an apparel manufacturer. The Attorney General of New York is now investigating the subject.

In looking at the cost to the consumer of higher prices, it is instructive to realize that many of the foreign camera manufacturers reduced the price charged by their U.S. marketing affiliate by up to 40% when faced with severe competition from imports in what has been poetically described by manufacturers as the "gray market." The fact of the matter, however, is that it is the potential importation of a product that provides price competition.

The catalog showroom industry sells more than one billion dollars of audio equipment, watches, cameras, and household goods such as china and crystal. We believe the financial cost to consumers of resale price maintenance is in the tens of millions of dollars annually today in only the product categories which we currently carry. If one were to add the sales of other categories such as clothing in other forms of retailing, the additional cost to the consumer could easily be hundreds of millions of dollars annually.

*19CFR 333.

While this is not yet the amount of excessive prices the consumer is paying, recent actions by federal antitrust officials in encouraging retail price fixing is leading the way to higher prices.

To the extent that resale price maintenance cripples price competition at the retail level where it is most workable, (because of the large number of competitors), it could have more far reaching implications by forcing a reallocation of resources to less efficient means of retail distribution. In this regard, it must be appreciated that if manufacturers are able to create the false illusion that retailers charging a lower price are inferior places with which to do business, the effect can go far beyond the loss of sales of a particular product, but can affect the ability of the retailer to attract business over a much wider variety of product lines. Indeed, we believe the whole purpose of the resurrection of retail price fixing by manufacturers is based on a simple economic assumption: A manufacturer who has previously spent large sums advertising his product at competitive prices, often obtaining a large share of the market, now seeks to enhance or to protect that market share from competitors by guaranteeing select retailers "above competitive profit margins." The intent is to induce certain retailers to "push" its product over that of other manufacturers. Manufacturers wish to set retail prices at non-competitive levels. Simply put, manufacturers say to favored retailers, "when consumers come into your store and ask which product is better, tell them my product is better, because I will set the retail price and guarantee you a higher profit than you can achieve on the competing lines." This is price fixing for the explicit purpose of obtaining non-competitive profit, traditionally and consistently recognized as an economic evil. It is already showing signs of leading to graver problems such as a recent series of blatant public statements by large retailers, putting their suppliers "on notice" that they do not intend to do business with manufacturers who sell to discount retailers. We respectfully encourage you to instruct the F.T.C. to investigate vigorously these and other resale price maintenance situations.

The F.T.C. should seriously consider the open invitation that it extends to manufacturers and retailers alike to participate in price maintenance arrangements by its stated public position on investigating and prosecuting "per se" violations. The F.T.C. should make a clear announcement to manufacturers and retailers alike that price fixing is wrong, and that it will uphold the law of the land. We believe it important that the Congress express its will, now.

In general, the atmosphere which has been created by the F.T.C.'s stated lack of intention actively to pursue and investigate per se resale price maintenance issues creates an environment which encourages department stores and other full margin retailers, perhaps independently but in parallel to put pressure on manufacturers to sell only full margin retailers, and thereby restrict distribution to discounters. The substance of their pressure is that if manufacturers sell discount retailers, those manufacturers will lose the business they currently enjoy with full margin retailers. The marketplace is full of examples of national manufacturers who coexist very successfully with all classes of retailers (Panasonic, Sony, Mikasa, General Electric, and on). We maintain that the atmosphere which allows this type of not-so-subtle pressure damages a free market environment. Retailers of all classes will carry these lines of merchandise, and the consumer will be the ultimate beneficiary.

Thank you for the opportunity to express our grave concerns.

NACSM General Counsel, Richard B. Kelly, who is fully familiar with the issues discussed, and I stand ready to respond to any questions which the Committee may have.

NACSM c/o
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The CHAIRMAN. Dr. Huntley, as I understand your position, are you satisfied with the law on the subject, but just feel the guidelines are not in accordance with the law, or do you favor changing the law, too?

Dr. HUNTLEY. I am satisfied, Senator, that the courts, guided by the wisdom of Congress, will continue to evolve the law in a satisfactory way, if not interrupted by these guidelines.

The CHAIRMAN. But you think these guidelines are not in accord with the law.

Dr. HUNTLEY. I believe they are not, yes, sir.

The CHAIRMAN. Thank you.

Mr. Stevenson?

Mr. STEVENSON. Senator, my name is A. Robert Stevenson. I am vice president of government and public relations for the Kmart Corp. I am here today on behalf of Kmart and the Association of General Merchandise Chains, to state that discounting is being threatened by the resurgence of resale price maintenance. Both Justice and the FTC have left the clear impression that resale price maintenance is permissible.

On January 23 of this year, the Justice Department issued guidelines which in fact undercut retailers' ability to sustain resale price maintenance actions. The guidelines overturn existing law and end per se illegality of resale price maintenance in some instances. My prepared statement has quite a few cites as to where we see deficiencies, but some of those include the narrowing of the definition of resale price maintenance, the encouraging of the concocting nonprice restraints to mask price restraints, and to resolve all doubts under the rule of reason. Also, they encourage high-price distributors to band together to cut off discounters. And added to that are the complicated economic formulas which would be almost impossible in most instances to sustain.

The guidelines also try to legitimize the idea that there is a so-called free rider or discounter defense which can justify price-fixing schemes. We feel that uniform sales prices do not necessarily translate into additional services, and that they are looking at the wrong end of the telescope in viewing this problem. Manufacturers have more efficient techniques of trying to get the services that they would require at the retail level through promotional allowances, et cetera. And efficiency should not be confused with service.

As to past history in this area, clearly, it is not high-tech type merchandise. What is being sold under resale price maintenance type of activities are blue jeans, cosmetics, candy, and so forth, which do not fall in the "high-tech" category. And even today, in Kmart stores, we sell computers which are high-tech items, without any problems.

In 1975, President Reagan prior to his presidency spoke out to debunk the "free rider" argument, and we wish the administration would take his lead.

The free rider notion, in our opinion, is a mask to escape competition. Some Federal agencies are trying to say that the *Monsanto* case justifies their inactivity, but the courts have held since *Monsanto* that resale price maintenance is against the law. In *Monsanto* itself, the court held per se illegality and granted a $10.5 million verdict to the plaintiff. It also said the manufacturers are not free to coerce dealers on price, and manufacturers cannot force distributors to stop shipping to discounters.

There is however certain unsettling language in *Monsanto* about the burden of proof, and manufacturers and dealers "acting independently." Congress should make it clear through legislation that; one, the plaintiff does not have to disprove unilateral action; two, and the plaintiff does not have to disprove nonprice motive. These two elements are clearly within the information and burden of the defendant, who should bear the burden and establish a valid nonprice-related reason for terminating a price cutter once it is established its competitors have complained to the manufacturer.

Contrary to FTC opinion, there have been successful cases—imposing damages for vertical price fixing—after *Monsanto,* and the FTC and the Justice Department should join in trying to do away with burdens that were unfairly added in *Monsanto.*

Private enforcement is just not the answer. It is just too time consuming and too costly for individual retailers to bring these types of actions. The Government has the better chance of enforcement because it can cut down on the delaying tactics of defendants that private litigants encounter and can create wider precedent.

We urge the committee to send these Federal agencies the message to protect consumers and distributors. We have listed in our testimony areas where manufacturers have refused to sell us directly, many times however we can get some of this merchandise through third parties, and we feel that we should be allowed to continue doing so.

By not enforcing resale price maintenance consumers will end up paying more, and we feel that there is a serious consumer interest here. We have estimated that the cost to consumers for not enforcing these laws is about $28 billion a year, and at Kmart alone, it could well be $1 billion.

The CHAIRMAN. Is it your opinion that these guidelines will cause the consumers to pay more?

Mr. STEVENSON. That is my opinion, and I think that has been the testimony, when you were chairman of this committee back when the fair trade laws——

The CHAIRMAN. When the fair trade matter was up. I remember that. What year was that?

Mr. STEVENSON. Nineteen seventy-five.

The CHAIRMAN. Yes. I was on the Commerce Committee at that time.

Mr. STEVENSON. I know you were very supportive of this. We feel that resale price maintenance is a bill of rights for consumers, and that there also is the commercial right here for the retailer to establish his own price. There is no proof that there is a need for a change in this law, and it is up to the proponents of price-fixing of change to show where there is a need. The FTC and the Justice Department have not only failed to enforce the law, but have tried to undermine it.

We ask Congress to do pretty much what the NMRI stated in their previous testimony: one, to support the Rudman-Metzenbaum resolution against the vertical price guidelines, two, to attach appropriation riders preventing Federal agencies from changing the law, and; three, for Congress to remedy the evidentiary problems found in *Monsanto.*

We would suggest as one remedy that the termination of distributors following price complaints be prima facie evidence of an illegal price-fixing conspiracy, and that ought to be made into law.

[Statement follows:]

STATEMENT OF

THE ASSOCIATION OF GENERAL MERCHANDISE CHAINS, INC. (AGMC)

PRESENTED BY:

A. ROBERT STEVENSON

VICE PRESIDENT

GOVERNMENT AND PUBLIC RELATIONS

K MART CORPORATION

Thank you, Mr. Chairman. My name is A. Robert Stevenson. I am Vice President of Government and Public Relations for K mart Corporation ("K mart"). I am testifying today on behalf of the Association of General Merchandise Chains, Inc. ("AGMC"). AGMC represents the nation's price-competitive general merchandise retail industry. AGMC's membership includes retail companies that operate more than 20,000 discount, variety, dollar, junior department, family center, off-price, factory outlet, catalog showroom and other general merchandise stores. These companies range in size and include many of the nation's largest retail chains as well as companies active in one or more regions of the country. AGMC member company stores are located in all 50 states and account for over $50 billion in annual sales.

K mart operates over 2,000 discount department stores where consumers can purchase brand name and private label merchandise at substantial savings off manufacturers' suggested list prices. The operation of such discount stores has been increasingly threatened in recent years by the resurgence of resale price maintenance programs initiated by manufacturers of trademarked merchandise.

Unfortunately, both the Federal Trade Commission and the Department of Justice, through their public statements and a lack of speedy and effective enforcement activity, have fostered the impression that resale price maintenance, which has long been prohibited by the antitrust laws, is today permissible.

THE DEPARTMENT OF JUSTICE
VERTICAL RESTRAINTS GUIDELINES

On January 23, 1985, the Antitrust Division of the Department of Justice published a document entitled "United State Department of Justice Vertical Restraints Guidelines,"

While the Guidelines purport to deal with "nonprice restraints," without changing the law, the definitions of particular practices and rules of procedure undercut the ability of retailers to pursue treble damage litigation against resale price maintenance.

The Guidelines acknowledge that "for many years resale price maintenance has been held to be illegal per se." Therefore, the Department of Justice claims, "these Guidelines do not apply to resale price maintenance." Vertical Guides § 2.3. However, the Guidelines attempt to overturn existing law in a number of significant respects. They would, in fact, narrow the current definition of resale price maintenance and to end its per se illegality in some instances. This constitutes a very real -- although indirect -- attack on the well-settled law in this area.

While the Guidelines claim they only are trying to eliminate the claimed "uncertainty" in the law, they would do that by declaring that virtually all vertical restraints, price as well as non-price, are per se lawful.

In the definition of price-fixing, the Guidelines would undercut decisions which have held that it is not necessary that a specific price be set in order to establish a violation of Section 1 of the Sherman Act based upon a theory of resale price maintenance.

Just as objectionable and contrary to settled law on resale price maintenance is the new Guidelines presumption that if a supplier has any bona fide restrictions that do not involve price, then even "ancillary" price restrictions should be judged under the rule of reason. So they would announce the rule that "anything goes" as long as a vertical restraint could be categorized as non-price. This invites would-be price-fixers to concoct supposedly non-price restraints on distribution in order to circumvent the clear ban on resale price maintenance.

In another highly dubious statement, the Guidelines propose a presumption that "where there are doubts, characterization [of] issues involving vertical restraints should be resolved in favor of a determination that the rule of reason, rather than per se should be applied." Vertical Guides § 2. This rule appears to reverse the more traditional procedure which allows a jury to determine whether a principal purpose of a restraint is to restrict prices or to accomplish some other (perhaps lawful) purpose. We believe this is yet another indirect attack on the per se illegality of resale price-fixing.

The new Guidelines would also allow dealers collectively to urge their suppliers to terminate offending price cutters, and claim that such action should be regarded as vertical rather than horizontal action. In other words, the Guidelines virtually invite high-priced distributors to band together in order to coerce suppliers into cutting off discounters. Vertical Guides § 2.1 n.11.

This statement is in direct conflict with the rule announced by the Supreme Court in United States v. General Motors Corp., 384 U.S. 127, 145 (1966), that "[e]llimination by joint collaborative action of discounters from access to the market is a per se violation of the Act."1/

The Guidelines also try to substitute mechanical market share formulas in place of an impartial analysis of all the relevant facts of a particular vertical restraint. Those formulas are so drawn that only cartels or monopolists would face any risk at all of even minimal scrutiny.

The complex economic data that these formulas require will be difficult or impossible for a treble damage plaintiff (or the government) to obtain, even with the broad use of subpoenas, depositions, interrogatories and document requests. As a

1/ This rule could also have international implications, particularly in the trademark license area. Manufacturers in different countries, who have the capacity to be competitors, might enter into agreements not to sell to discounters. Although such arrangements have traditionally been treated as horizontal (and hence per se illegal), the new definition in the Guidelines would seem to give them a presumptive legality, even if they were directed at discounters within the United States.

practical matter, having to prove the practices of all competitors in a market may make it virtually impossible for a small treble damage plaintiff to prevail, even if it is the victim of the most blatant price-fixing conspiracy.

There are numerous other defects in the Guidelines, in areas such as dual distribution and intellectual property licensing, but perhaps none as pernicious as these on price-related vertical restraints.

THE "FREE RIDER" FALLACY AS A JUSTIFICATION OF RESALE PRICE MAINTENANCE

One great danger in the new Guidelines is that they would allow admitted price-fixing programs to be excused by a defense that the manufacturer had a bona fide purpose of keeping "free riders" or "discounters" from obtaining merchandise. Indeed the Guidelines suggest that a manufacturer may take collusive action to terminate dealers who "charge a lower price or earn a larger profit" than other dealers. Vertical Guides § 3.1.

The Vertical Guidelines are not the first time in the last five years that the Department of Justice has tried to justify retail price-fixing as necessary to help manufacturers give competing retailers a large enough margin to ensure that they provide services which the manufacturer deems necessary to promote and service the product. Under this flawed analysis, retailers who compete on the basis of price undercut margin levels and encourage "free riders" to take advantage of services provided by other distributors.

Uniform sales prices, however, need not translate into <u>any</u> additional services, much less the <u>specific</u> services the manufacturer desires.

Manufacturers have many other, more effective techniques for promoting or assuring the provision of services they desire, such as promotional and other allowances, factory service, direct payment to dealers providing services, and a variety of other contractual techniques.

Price-competitive retailers are not "free riders"; instead they are more efficient distributors meeting customer demand. Many price-competitive retail companies offer not just economy, but also services at least equal to those in full-price outlets. Brand-name discount companies often provide or arrange for services for the merchandise they sell. In addition, many price competitors have aggressive policies of customer satisfaction.

Nor are other rationales advanced to justify resale price maintenance any more persuasive. When advocates of resale price maintenance give examples to support the "free rider" theory of products for which extensive pre- and post-sale services are needed, they often cite high technology items. Yet even a casual examination of products whose prices were controlled under "fair trade" laws reveals only a few categories of goods that might require some services. Blue jeans, toiletries, cosmetics, candy, knives, china, dolls and toys have been subject to price restrictions, but hardly qualify as high technology items.

Even among legitimate high technology items, resale price maintenance has been shown to be totally unnecessary. Products as complex as home computers are routinely sold and serviced at competitive prices in stores like K mart.

In 1975 President Reagan himself debunked a large part of the "free rider" rationale, when he wrote:

> Pro-fair trade forces argue that the higher margins provided the retailer by fair trade laws result in more retailers carrying the line, and with a broader selection at that. That may be true, but in an age when advertising has effectively pre-sold so many brand names, is the retailer really providing any extra useful service to the consumer in exchange for that higher margin? It's nice to know that he carries a broad selection, but without fair trade, wouldn't an enterprising merchant carry as broad a line of, say, cosmetics as his customers demand? 1212 Cong. Rec. 1268 (Jan. 23, 1975).

In our view, the free rider theory is just a mask for competitors who wish to escape competition.

CONGRESS SHOULD ADDRESS THE EVIDENTIARY ISSUES RAISED BY MONSANTO

Some Federal antitrust officials rationalize their failure to enforce the law by referring to the Supreme Court's decision in the Monsanto decision last year.[2]

The plaintiff in Monsanto was a discount wholesale distributor of Monsanto herbicides. Monsanto refused to renew Spray-Rite's distributorship after receiving complaints from Spray-Rite's competitors that Spray-Rite was cutting prices. The Court of Appeals for the Eighth Circuit held that this proof was sufficient to establish a conspiracy to fix resale prices violative of Section 1 of the Sherman Act.

On certiorari, the Supreme Court held that resale price maintenance continued to be per se illegal. However, the Supreme Court overruled previous decisions in which courts had held that evidence of complaints to a manufacturer from its distributors about the pricing practices of another distributor could, by itself, support a price fixing theory after termination of that distributor. The Court concluded that "[t]here must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently." 104 S. Ct. at 1471.

The Supreme Court recognized the manufacturer's need to communicate and constantly attend to the needs of its distribution system. It further recognized that there will always be some complaints from distributors about price cutters. The Court expressed its recommendation of a so-called public policy interest in preserving that exchange of information.

Having enunciated this rule of law, the Court then went on to find that there was ample "plus evidence" in the Monsanto record upon which to base a conspiracy judgment against the defendant, i.e., the plaintiff had met its burden to "prove, as well as allege, that the nonprice restrictions were in fact part of a price conspiracy." 104 S. Ct. at 1468 n.6.

Against this background, it is important to recognize what the Supreme Court did and did not do in Monsanto:

The Supreme Court did confirm that resale price maintenance remains per se illegal. 104 S. Ct. at 1469.

The Supreme Court did not suggest that a manufacturer

2/ Monsanto Co. v. Spray-Rite Service Corp., 104 S. Ct. 1464 (1984).

was free to coerce its dealers into holding a suggested resale price, that a manufacturer could force distributors or dealers to cease shipping to price-cutting retailers, or that a manufacturer who in fact was influenced by retailer complaints and agreed with retailers to cut off a price-cutting reseller was free from the stigma of vertical price maintenance.

The Supreme Court did affirm a $10.5 million verdict for the plaintiff.

Nonetheless, requiring a plaintiff to prove "plus factors" may make it much too difficult to establish a conspiracy. Indeed, some Circuit courts and several lower courts since Monsanto have interpreted the new requirements voiced by the Supreme Court very adversely to retailers, while other courts have held that the required additional proof (such as meetings between the complaining dealers and the supplier) may be sufficient to support a conspiracy verdict.

In the interest of seeing that resale price maintenance not only remains illegal, but also that the law remains enforceable, Congress should enact legislation making clear: That the plaintiff should not have to disprove unilateral action; and that the plaintiff should not have to disprove a nonprice motive. Evidence on these issues is particularly within the custody and control of the defendant, and the defendant should bear the burden of establishing a valid, non-price related reason for terminating a price cutter, once it has been established that the plaintiff was cut off after its competitors complained to the manufacturer about its prices. Unless a finder of fact can reasonably infer a price-fixing motive for such terminations when no other plausible explanation exists for the cut off, antitrust enforcement -- private or public -- will face serious obstacles.

FEDERAL AGENCIES HAVE FAILED TO ENFORCE THE LAW

Federal antitrust agencies' persistent non-enforcement of the law against resale price maintenance raises serious questions. The Chairman of the Federal Trade Commission has professed his belief that the Monsanto case has obliterated the agency's ability to prove a resale price maintenance case. Fortunately, that has not been the uniform experience of the American judicial system. While there are a predictable number of decisions that find that mere dealer complaints, plus termination, are not enough to spell out conspiracy, decisions in the Fifth, Sixth and Tenth Circuits have affirmed the principle that a manufacturer cannot coerce its customers into acquiescing in resale price maintenance.3/ We do, however, believe that the Monsanto decision has raised some new barriers to some plaintiffs. Rather than point to this to excuse their inactivity, the Federal antitrust officials should be joining us in urging you to remedy that problem.

The Federal antitrust agencies would have Congress excuse their failure to prosecute resale price maintenance by pointing to the deterrent effect of the *per se* rule and the need for private, not public, enforcement.

This is a classic example of passing the buck. The antitrust agencies are funded with the tax revenue of United States citizens and endowed with vast powers to protect those citizens from injurious illegal acts such as resale price maintenance. Private treble damage actions are at best time-consuming and horribly expensive for the retail segment. The extensive discovery rights granted to defendants interested in prolonging illegal conspiracies through procedural delays provide a fertile field for a war of attrition against the retailer who seeks speedy access to the market place.

The public pays the cost of keeping the Department of Justice and the Federal Trade Commission in business. The public should have the benefit of the procedural sanctions which these

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3/ Pierce v. Ramsey Winch Co., 753 F.2d 416 (5th Cir. 1985); Bender v. Southland Corp., 649 F.2d 1205 (6th Cir. 1984); World of Sleep, Inc. v. La-Z-Boy Chair Co., 756 F.2d 1467 (10th Cir. 1985).

agencies can bring to bear against illegal actions. Under the circumstances, we urge the Committee to send the antitrust agencies a direct message that action must be taken to protect the consumer and distributor.

THE RISE OF ANTICOMPETITIVE BEHAVIOR

Resale price maintenance is a serious problem in the marketplace, and it is unfortunately on the upswing. Certain manufacturers, and especially those producing so-called "prestige" merchandise, are not happy with the fact that K mart and other discounters are sometimes able to obtain their goods. As you know, many such manufacturers encourage high resale prices as a means of demonstrating the supposed superior quality of their goods to consumers. Our refusal to go along with such policies has led many producers to refuse to deal directly with us. In fact, our buyers have informed me that dozens of well-known suppliers of apparel, household items, watches, electronics, jewelry and cosmetics will not deal directly with K mart since we sell to consumers at a discount.

Until now we have often been able to make the best of this situation by purchasing the items through third parties for resale at substantial discounts to our customers. One leading name-brand watch which we must purchase indirectly has a cost of 20¢ per dollar on the manufacturer's listed retail price. For example, a $250 list price watch has a cost price of $50. When promoted on an in-store promotional program, we can sell this watch at 66% off list, at under $100 retail, and still achieve an adequate return.

More than 40 manufacturers of nationally advertised brands of menswear refuse to sell directly to K mart. Many women's wear, luggage, shoe and prestige fragrance manufacturers follow the same policy of refusing to sell to discounters. The net effect is to force the discounters to incur a higher cost by buying through a third party. The consumer, of course, is the ultimate victim, because he or she bears the brunt of this price raising tactic. However, the injury to discounters and to the public is magnified many-fold when these manufacturers require distributors and other third persons to refrain from selling to discounters. In the past, the Department of Justice instituted major lawsuits to halt such conspiratorial activity. Today such collusive combinations are allowed to proliferate to the detriment of the ultimate consumer.

If the Vertical Guidelines succeed in undermining the current law, or if resale price maintenance ever loses its per se illegality, discounters could be forced to observe the manufacturer's arbitrary pricing rules, since we will no longer be able, as a practical matter, to bring private antitrust actions to challenge vertical price-fixing. The same would be true if evidentiary rules make resale price maintenance cases overwhelmingly difficult to win. In short, if the Justice Department and Federal Trade Commission succeed in removing the legal prohibition against resale price maintenance, both interbrand and intrabrand price competition will evaporate.

In large measure, the very reason for the existence of K mart and other discounters -- the offering of quality merchandise at discount prices -- will disappear as well. And of course American consumers will be forced either to purchase products at inflated and noncompetitive prices or, in many instances, to do without the products altogether. In either case, they will largely have lost their freedom to purchase merchandise at the best possible competitive price and under the terms they choose.

The current efforts to weaken the enforcement of the antitrust laws relating to resale price maintenance are ill-advised, unjust and immeasurably harmful to American consumers.

Based on historical experience from the days when "fair trade" prices were in place, the potential cost to American consumers for not vigorously enforcing current law could easily exceed $28 billion annually.* At K mart alone, the effect could

* In 1985, retail sales of all merchandise excluding that generated from the sale of passenger cars, food stores, eating and drinking places, gasoline stations and liquor stores (i.e., general merchandise) will exceed $567 billion, according to the Bureau of Census, United States Department of Commerce. This is the retail merchandise that in the past was most often fair traded. If the average cost of this merchandise to the consumer were to increase by only 5%, the total bill would be more than $28 billion this year.

easily raise retail prices by at least $1 billion, if K mart were willing to adhere to fixed retail prices.

CONCLUSION

The law prohibiting resale price maintenance provides an economic bill of rights for consumers.

It also establishes one of the most fundamental commercial rights, which is the right to establish a retail price free of coercion from suppliers.

In 1975 Congress repealed state "fair trade" laws, which had allowed producers to prohibit sales below a fixed price, after extensive evidence that such anti-competitive trade restraints add billions to consumer prices.

While the economic damage caused by vertical price fixing has been amply demonstrated, those arguing for change have not shown the need for such a move or estimated the costs to consumers, retailers and the economy.

Unfortunately for the public, the officials sworn to uphold the law which protects price competition have not only utterly failed to enforce the law, but have actively tried to overturn or undermine it. The Vertical Guidelines are just the most recent example of this.

We therefore call on Congress to take the following steps to preserve price competition and protect consumers:

First, Congress must enact the Rudman-Metzenbaum resolution on Vertical Guidelines to make clear that Congress will not tolerate agency attempts to undermine the laws it has written.

Second, Congress must once again, as it did in enacting the Fiscal Year 1984 appropriations for Federal antitrust agencies, re-emphasize its support for the per se illegality of resale price maintenance as part of the authorizations/appropriations process.

Finally, Congress should remedy the evidentiary problems created by the Monsanto decision: one suggested remedy would make the termination of a reseller following price-related complaints by a competing reseller prima facie evidence of an illegal price-fixing conspiracy. In that way, victims of price-fixing can obtain the relief Congress intended, and Federal antitrust agencies will not be able to excuse their failure to enforce the law.

Thank you for giving me the opportunity to comment on this critical issue.

7/31/85

RESPONSE OF A. ROBERT STEVENSON
TO QUESTIONS FOR BUSINESS PANEL

1. The Vertical Restraints Guidelines were an extraordinary pronouncement from the Department of Justice -- a formal acknowledgment that the federal government would no longer enforce the per se illegality of resale price maintenance. Perhaps even worse, it is a document that defendants in private treble damage litigation can cite to courts as the definitive opinion of the nation's chief antitrust enforcement authority that all manner of joint activity affecting price should not be considered a per se violation of the antitrust laws. These Guidelines are obviously designed to influence judges in their determination of future litigated matters. While the Guidelines purport to be a restatement of existing law, they actually misstate the law pertaining to resale price maintenance, thus maximizing the possibility that a court relying on the Guidelines will water down or ignore the rule of per se illegality that governs concerted action designed to affect resale prices. Given the admitted persuasiveness of the Department of Justice, it is clear that the enforcement of the law is clearly in jeopardy. Congress, as the author of the antitrust laws (and the Consumer Goods Pricing Act of 1975 which repealed the so-called Fair Trade law) should make a definitive statement that it regards the Vertical Restraints Guidelines as an aberration which does not accurately reflect law and which was adopted without the proper opportunity for meaningful participation by interested and affected citizens. Otherwise, the purpose and intent of Congress in enacting the antitrust laws and the Consumer Goods Pricing Act of 1975 may be obstructed and impeded by this unauthorized and wholly unilateral Antitrust Division action.

2. The economic effects of vertical restraints vary depending upon the particular restraints involved. Both the courts and economists have recognized in the past that the most inimical of all of these restraints are conspiracies directed at fixing, stabilizing or affecting the resale prices available to the consumer. It is in recognition of this clearly inimical economic effect, that the courts have uniformly held that such

conspiracies are illegal per se. One of the principal drawbacks to the Department of Justice's so-called Vertical Restraints Guidelines is to provide a basis for argument directed at watering down that uniformly accepted rule of per se illegality. Under these Vertical Restraints Guidelines, the per se rule would be strenuously limited in its application, far beyond the perimeters specified in the reported cases. Indeed, the economic effects of such Guidelines, if accepted, would be drastic. For example, at K mart alone, consumer prices would be raised by $1 billion annually if K mart were forced to adhere to suggested resale prices. Overall, the impact on the consumer could exceed $28 billion this year alone if such vertical practices were allowed.

3. No. The key phrase in this question is "desired point-of-sale services." Vertical restraints prevent the consumer from choosing the level of services he or she desires. Some consumers prefer to deal by mail; others patronize catalog showrooms. Many visit discount department stores or warehouse outlets. Others deal primarily with department stores. All in all -- and this probably depends a great deal on the particular item involved -- the consumer purchases where he or she gets the desired level of service at the best price. There is no indication that the consumer foregoes "desired" services when shopping at a discount store, or that full price stores necessarily have a more expert sales staff. K mart and other discount stores advertise at least as intensively as their full-price competitor. There is certainly no correlation between the cleanliness of showrooms and the retail price of goods. The important point is that price-fixing agreements do not lead to viable consumer oriented services. To the contrary, price-fixing is a device by which the consumer is forced, without choice to pay a higher price than he desires. The benefits of the competition which protect consumers from such gouging are wholly denied when resale price maintenance is permitted under the guise of the so-called Vertical Restraints Guidelines.

4. The proliferation of vertical restraints will stifle retail competition and innovations which benefit the consumer. The entrepreneurial spirit which has been the hallmark

of retailing in recent years will be smothered if manufacturers and suppliers can agree that only high priced retailers will have access to their merchandise. Further, there will be no incentive for retailer efficiency if high profit margins are guaranteed by vertical restraints. The very existence of discount retail operations will be threatened. As under "fair trade," the consumer will pay billions annually to inflate corporate profit margins if vertical restraints are unchecked.

5. Yes. Many manufacturers have refused to deal directly with K mart on the purported basis that they are a "discount" operation. These refusals to deal occur most frequently when full price retailers have complained and sought manufacturer action to halt discounting of prices. Regrettably, the number of instances of manufacturers refusing to deal with K mart has increased since the Department of Justice commenced its policy of refusing to enforce the antitrust prohibitions against resale price maintenance. The encouragement provided by the Vertical Guidelines will doubtless subject K mart, and countless other retailers, to additional conspiratorial injury.

6. The Monsanto case will make legal redress more difficult for the private litigant because of the evidentiary burden which it imposes. Antitrust litigation has always been expensive because of the difficulties of obtaining evidence from a reluctant defendant. The burden would be almost insurmountable if courts interpret Monsanto as requiring that the plaintiff disprove all non-price related explanations for the termination of a discounter following complaints from its competitors. But, it should be emphasized that the burdens imposed by Monsanto are small compared to the potential burdens which will be imposed upon retailers if the so-called Vertical Guidelines are given effect by the courts. These Vertical Guidelines go beyond the sanction of the Monsanto decision. Monsanto dealt only with the question of quantum of proof necessary to establish a conspiracy. The Vertical Guidelines are designed to validate certain restraints after a conspiracy has been proved. In effect, these Guidelines impose new barriers to the victims of resale price maintenance which have never been contemplated or sanctioned by the courts.

The CHAIRMAN. I understand there is going to be a bill introduced to change the *Monsanto* decision. How would you feel about that?

Mr. STEVENSON. We would be supportive.

The CHAIRMAN. And as I understood generally, you feel these guidelines are inconsistent with the law, but still, you want the law changed on the *Monsanto* decision; is that correct?

Mr. STEVENSON. Yes, that is true—only on the evidentiary point, Senator.

The CHAIRMAN. In other words, you favor most of the present law, except the *Monsanto* decision on evidence?

Mr. STEVENSON. Well, the *Monsanto* decision does present some difficulties, but they are not insurmountable, and from a consumer point of view, we think that the evidentiary rule ought to be changed.

The CHAIRMAN. Dr. Huntley, is that your thinking, exactly as he expressed it, or do you have any variance?

Dr. HUNTLEY. Well, if I had my druthers, Senator, I would prefer to see the evidenciary rule in *Monsanto* changed. But I would be more than happy to give that up in return for the death of these Justice Department guidelines.

The CHAIRMAN. In other words, you feel these guidelines are against the public interest, against the consumer?

Dr. HUNTLEY. I do, sir.

The CHAIRMAN. Mr. Jelin, do you feel the same way?

Mr. JELIN. Yes, sir, I do. I think the NMRI feels, and I certainly feel, that the *Monsanto* decision needs some clarification, particularly on the question of the evidence needed to prove a conspiracy. We would support whole-heartedly Senators Rudman and Metzenbaum in that effort. But we do feel that the primary concern here is that these guidelines be withdrawn. They are contrary to existing law.

The CHAIRMAN. Mr. Milstein, do you feel these guidelines are against the interest of the consumer?

Mr. MILSTEIN. Yes, I think they are detrimental to the consumer and the free enterprise system in the United States as we currently know it.

The CHAIRMAN. I want to thank you gentlemen for your testimony here, and I think that concludes the hearing.

We now stand adjourned.

Thank you.

[Whereupon, at 12 o'clock p.m., the committee was adjourned.]

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