FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
THE CHAIRMAN

February 14, 1986

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

Dear Mr. Chairman:

The Federal Trade Commission welcomes the opportunity to comment on S. 1445, "The Retail Competition Enforcement Act of 1985." S. 1445 would amend the Sherman Act by providing:

> 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 Commission strongly opposes the enactment of S. 1445, designed to overturn a recent ruling by the Supreme Court in Monsanto Co. v. Spray-Rite Service Corporation,1/ because it would have adverse consequences for competition, economic efficiency, and consumer welfare. More specifically, we have two concerns about the bill's proposed conspiracy standard. First, it permits a jury to infer conspiracy from potentially pro-competitive communications. Second, it provides an incentive for manufacturers to adopt different methods of distribution even when these would otherwise not be efficient. In addition, the bill in its present form raises the question of whether its effect would be to alter vertical restraints law substantially beyond the stated intentions of its original sponsor.

An example will illustrate that manufacturers and resellers may have legitimate reasons to exchange information, not only about price, but also about the reception of products in the

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1/ 465 U.S. 752 (1984). The intent to overturn Monsanto was the stated reason for introduction of the bill by its sponsor, Senator Metzenbaum. Congressional Record, July 16, 1985, S. 9579.

market. Suppose a ski equipment manufacturer questions one of its dealers about the dealer's declining sales. The dealer responds:

> First we have the problem with dealers who sell the equipment without seeing that it fits the customer or instructing the customer on how to use it. In this business, if you don't give proper fitting or instructions the customer might break a leg. Then you or I can be sued. Another problem is the customer who comes in and finds out what equipment is best, receives instructions on its use, then buys at some place like a temporary booth set up in a shopping center from a seller he won't find again. Providing service costs me money. Dealers who don't provide services can undercut me because they don't have to hire the number of trained salespersons necessary to give customers personal attention.
>
> Here's what you should do. If you want to improve your sales and my sales, try upgrading the image of this product. You should find and maintain only those dealerships that provide good service and show this off as a first-class, high-quality product.

At this point, the manufacturer wishes the dealer luck and walks away. Several weeks later, the manufacturer terminates a number of discounting dealers.

Under the proposed legislation, the above conversation, coupled with a dealer termination, would permit an inference of conspiracy. Yet the conversation is pro-competitive. The dealer is providing the manufacturer with important information about certain facts of retailing -- it costs money to provide valuable services, and service-oriented dealers need sales and profit margins sufficient to provide those services and hire trained sales personnel. Moreover, the dealer is suggesting a marketing strategy -- to concentrate on the upscale niche in the market -- that might be effective in boosting sales. The dealer also correctly notes that if these services are not provided, the dealer and the manufacturer may be subject to tort liability. In this case, it might make perfect sense for the manufacturer to protect his service-oriented dealers and minimize his own product liability risk by terminating dealers that transship products to dealers that provide no service.

Distributors are an important source of information for manufacturers. As the Supreme Court noted in Monsanto, one

important type of information is simply how best "to assure that their product will reach the consumer persuasively and efficiently."2/ Further, as the Court noted, manufacturers have a legitimate interest in ensuring that their distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen, or demonstrating the technical features of a product.3/ To ensure this, the manufacturer may need to prevent interference from "free riders."

The Commission recently endorsed precisely these principles in an order granting a petition to modify a consent agreement filed by Salomon/North America, a skiing equipment manufacturer.4/ The original order, inter alia, prohibited Salomon from restricting "the class or type of customer" to whom its dealers could sell its products (transshipment restrictions), and from restricting the "site or location" at which its dealers could sell its products (location restrictions).5/ In granting Salomon's request to delete these prohibitions, the Commission noted that transshipment and location restraints imposed by Salomon would not threaten competition. The Commission concluded:

> Salomon's inability to ban transshipping and sales from unauthorized locations would likely cause Salomon significant competitive injury by, among other things, lessening the efficiency of Salomon's distribution system, discouraging dealers from remaining with Salomon, exposing Salomon's customers to increased risk of injury and, consequently, exposing Salomon to personal injury claims.6/

Communications from dealers that simply convey this sort of very important and pro-competitive information to manufacturers should

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2/ 465 U.S. at 763-64.

3/ Id. at 762-63.

4/ Salomon/North America, Inc., Docket No. C-2859 (F.T.C. July 30, 1985), modifying Salomon/North America, Inc., 89 F.T.C. 24 (1977) (consent order).

5/ Salomon/North America, Inc., 89 F.T.C. at 27.

6/ Salomon/North America, Docket No. C-2859 (F.T.C. July 30, 1985), slip op. at 2.

be encouraged, rather than characterized as the basis for an inference of conspiracy.7/

The proposed legislation could also make distribution less efficient and lead to the decline of retailing in its present form. Facing the threat of treble damages liability for pro-competitive conduct, and uncertain when they could legally terminate a dealer, manufacturers might decide to distribute their product themselves. This probably would be less efficient. Manufacturers presumably now sell predominantly through independent dealers because that is the most cost effective form of distribution. The legal impediment that would be created by this legislation could lead manufacturers to a less efficient means of distribution. The legislation thus would have the ironic effect of hurting the retailers it purports to protect.

Consequently, enactment of S. 1445 would unwisely overrule the conspiracy standard the Supreme Court reaffirmed in Monsanto. In Monsanto, the Court held that in distributor-termination cases

> there must be evidence that tends to exclude the possibility of independent action by the manufacturer and distributor. That is, there must be direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective.8/

The Monsanto Court thereby rejected an approach taken by a minority of the circuit courts that "proof of termination following competitor complaints is sufficient to support an inference of concerted action."9/

The Supreme Court's approach to defining conspiracy in Monsanto is consistent with a long line of well-reasoned federal court cases. In one of its first efforts to address the elements that constitute an agreement under Section 1 of the Sherman Act,

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7/ See Overstreet, Resale Price Maintenance: Economic Theories and Empirical Evidence (FTC Staff Report 1983) at 13-62 for an explanation of various anticompetitive and procompetitive rationales for imposing vertical price restraints.

8/ 465 U.S. at 768.

9/ Id. at 758.

the Court indicated that the alleged conspirators must know that concerted action is contemplated or invited, and must have given "their adherence to the scheme and participated in it."10/ The Court later indicated that establishing the presence of an agreement requires a showing that the defendants have "a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement. . . ."11/ On the basis of these and other authorities, lower courts in more recent cases have generally taken the position that "[t]he substantive law of trade conspiracies requires some consciousness of commitment to a common scheme."12/

The proposed legislation is inconsistent with the basic elements of conspiracy law. The Monsanto Court noted the fundamental tenet of conspiracy law that there must be a conscious commitment to a common scheme designed to achieve an unlawful objective, i.e., "circumstances must reveal a unity of purpose or a common design and understanding, or a meeting of minds, in an unlawful arrangement."13/ These oft-repeated legal formulations show conspiracy has two prongs: a meeting of minds and an unlawful purpose. Under the proposed legislation, neither prong would have to be present for an inference of conspiracy.

10/ Interstate Circuit, Inc. v. United States, 306 U.S. 208, 226 (1939); accord, e.g., United States v. Paramount Pictures, Inc., 334 U.S. 131, 142 (1948); In re Plywood Antitrust Litigation, 655 F.2d 627, 634 (5th Cir. 1981), cert. dismissed, 462 U.S. 1125 (1983); Gainesville Utilities Dep't v. Florida Power & Light Co., 573 F.2d 292, 300 (5th Cir. 1978), cert. denied, 439 U.S. 966 (1978).

11/ See, e.g., American Tobacco Co. v. United States, 328 U.S. 781, 810 (1946).

12/ Klein v. American Luggage Works, Inc., 323 F.2d 787, 791 (3d Cir. 1963); United States v. Standard Oil Co., 316 F.2d 884, 890 (7th Cir. 1963); accord, e.g., Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 111 (3d Cir. 1980); Virginia Academy of Clinical Psychologists v. Blue Shield, 469 F. Supp. 552, 559 (E.D. Va. 1979); Duplan Corp. v. Deering Milliken, Inc., 444 F. Supp. 648, 691 (D.S.C. 1977); Harlem River Consumers Coop. v. Associated Grocers of Harlem, 408 F. Supp. 1251, 1268-69 (S.D.N.Y. 1976); United States v. General Motors Corp., 1974-2 Trade Cas. (CCH) ¶ 75,253, at 97,670 (E.D. Mich. 1974).

13/ 465 U.S. at 764, citing American Tobacco Co., op. cit. at 810.

One can contrast the proposed statute with the application of the current law of conspiracy by considering the example discussed above, in which the ski equipment manufacturer does not respond to the dealer, but at some future time terminates certain dealers.14/ In this example, there is no apparent meeting of minds and hence no conspiracy. The dealer probably would be quite surprised to discover that it had "conspired" with the manufacturer, rather than that it had simply attempted to communicate valuable information. Indeed, the terminations might have been occasioned by completely unrelated problems between the terminated dealers and the manufacturer. Nonetheless, the legislation would permit an inference of a conspiracy.

Moreover, the legislation permits the inference of conspiracy even when there may be no unlawful objective. The manufacturer's response in our hypothetical might have been to renew contracts only with those dealers who would accept a non-price contractual restriction such as a transshipment ban.15/ This conduct, judged under the rule of reason, could be entirely lawful and pro-competitive.

Additionally, the language of the bill, supra, might be interpreted to alter substantially vertical restraints law beyond the stated intentions of its sponsor.16/ Although S. 1445 does not state explicitly that the agreements that it condemns are illegal per se, it is sufficiently ambiguous that it might be interpreted to declare all those agreements not merely unlawful if unreasonably restrictive of competition but per se

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14/ The legislation offers no guidance on how long an inference of conspiracy could be drawn from the described communications. It might permit a court to draw the inference even when several years had passed between the conversations and the terminations.

15/ Non-price restraints such as transshipment bans are judged under the "rule of reason." Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 57-59 (1977). The Court there overruled a decision it had imposed only ten years earlier that such restraints were per se unlawful when imposed upon product purchasers. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 378-80 (1967). Simply put, the Court decided that in Schwinn it had misjudged the valid business purposes behind many non-price restraints.

16/ See supra note 1.

unlawful.17/ Indeed, the "refuse to supply" phrase in the first sentence could be read to overturn Sylvania and reinstate the per se illegality rule of Schwinn.18/ Further, the sweep of the bill's conspiracy inference might engulf the important exception to the per se rule contained in the venerable Colgate doctrine.19/ If the Committee wishes to clarify the intent of the bill on these points and receive the views of the Federal Trade Commission, the Commission would be happy to respond further on these possible legislative changes.

In sum, the Commission strongly opposes enactment of S. 1445. It would chill pro-competitive communications and business practices, it would distort conspiracy law and send it into uncharted territory, and it may well have consequences far beyond the overturning of Monsanto.

By direction of the Commission, with Commissioner Bailey dissenting.

Terry Calvani
Acting Chairman

17/ S. 1445 could be construed as codification of the court-made per se illegality rule for vertical price-fixing. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

18/ Overturning Sylvania would obviously have serious anticompetitive consequences. The Schwinn rule was short-lived; the Court agreed with economic analysts who argued that the Schwinn rule interfered with procompetitive business arrangements.

19/ United States v. Colgate & Co., 250 U.S. 300, 307 (1919). The Colgate doctrine permits a manufacturer's unilateral announcement of suggested resale prices and its refusal to deal with those who do not comply. The Supreme Court strongly (and wisely) embraced the Colgate doctrine in Monsanto: "If an inference of [a price-fixing] agreement may be drawn from highly ambiguous evidence, there is considerable danger that the doctrines enunciated in Sylvania and Colgate will be seriously eroded." Monsanto Co. v. Spray Rite Service Corp., 465 U.S. at 763.