

13. Resale Price Maintenance

Legal History¹

Dr Miles Medical Co. v. John D. Park & Sons Co.—1911

Miles sued Park. Miles made medicines from secret formulae. (This was park of the argument, but dismissed by the Sup. Ct.) This was the 1st RPM case. Miles had contracts with 4000+ wholesales and 25,000 retailers that foreband them from selling Miles' medicines at prices below those stipulated by Miles. Park was sued because it induced suppliers to sell to it and then turned around and sold at cut-rate prices. (Presumably, Miles sued Park because it could not determine who was selling to Park.)

In this first case, the court laid the ground work for the future. Court upheld the Common Law right of alienability. (Lord Coke and some horses.) In the process, the court ruled against RPM. Essentially the court ruled that RPM was bad because it violated the rule of alienability and that restricted trade. Since the Sherman Act was passed to enhance trade, RPM was a violation. This legal idea has been tempered and refined since, and the idea of the right of alienability does not reappear. Even so, the court has more or less stuck by this original ruling, balanced by the *Colgate Doctrine* discussed below.

U.S. v. Colgate—1919

Colgate (seller of soap products) had a policy of refusing to deal with vendors who sold below suggested retail price. Colgate spent a good deal of resources in determining who maintained their suggested prices and who did not. Unlike Miles, however, Colgate simply refused to continue to deal with a vendor that Colgate determined was not abiding by the rules. Miles had contracts which it had attempted to enforce that would stop cut rate selling immediately. Colgate was willing to allow a vendor to sell out current inventory. Colgate's policy was to not resupply.

Court affirmed the right of a business to sell to whomever it pleases. This right is subject to the proviso that there be no purpose in the refusal to deal to create or maintain a monopoly. Since there was no combination or conspiracy in the Colgate case, the court was unwilling to cross the line and search for monopoly shaddows on the other side.

This case has come to be known as the *Colgate Doctrine*. Individual action in the refusal to deal is ok unless the action is an attempt to create or protect a monopoly.

Keifer-Stewart Co. v. Jos. E. Seagrams & Sons—1951

Seagrams had a policy of maintaining a maximum resale price by its wholesalers. Calvert was another distributor but wholly owned by Seagrams. Apparently the operational control of the

¹ Richard Posner and Frank Easterbrook, *Antitrust Cases, Economic Notes, and other Materials*, West, 1981.

two companies was disjoint. However, word came down from the top for Calvert to go along with Seagrams in enforcing its max RPM.

Court said, “Sherman Act makes it an offense for respondents to agree among themselves to stop selling to particular customers.”

Posner and Easterbrook are critical of this case because of the issue of integrated ownership. (Apparently Perma Life is another case of a similar ilk.) In spite of P&E’s criticism, the case follows the court’s prior pattern. When refusal to deal is linked to concerted action, it is illegal.

Klor’s Inc. v. Broadway-Hale Stores, Inc.—1959

Manufacturers and distributors of electrical appliances (Emerson, GE, etc.) in combination with Broadway-Hale agreed to refuse to deal with Klor. (Apparently Klor was next to B-H and selling cut rate, free riding on B-H’s store display, etc. B-H argued in defense that it was not attempting to monopolize because there were numerous stores selling the same stuff nearby.)

Court said that combination to create monopoly is illegal even if the monopoly effect is a “creeping one” as opposed to one on a gallop.

U.S. v Parke Davis & Co.—1960

Another RPM case. Parke used threat of refusal to deal with wholesalers to get them to refuse to deal with retailers who did not go along with RPM.

Court said that this violated the *Colgate* protection. If Parke had simply refused to deal with wholesalers who cut price, that would be ok. However, it was the effort to get the wholesalers to enforce the retail RPM that went over the line. The court remarked on the extent of the concerted action. Parke worked the compliance of large retailers as a lever to get smaller retailers to go along. Even so, the court did not seem to look for evidence of monopoly harm on the other side of the line.

U.S. v. Gen. Motors Corp.—1966

Store front auto sales sprang up in downtown L.A. These discounters were getting cars shipped in from out of town dealers. Many times the cars were “preped” by the regular in town dealers. Regular dealers got mad, asked GM to stop the cross shipping. GM used the “location clause” in their dealership contract to lean on the out-of-town dealers. Location clause says that a dealer can only operate at its designated place of business unless a move is approved by manufacturer.

Court did not strike down the location clause, but it did rule against GM. The court said that the concerted action of GM and the other dealers was a restraint of trade in violation of Sherman. “We have here a classic conspiracy in restraint of trade: joint collaborative action of dealers, the appee association, and General Motors to eliminate a class of competitors by terminating business dealing between them and a minority of Chevrolet dealers ...”

Monsanto Co. v. Spray-Rite Service Corp.—1984²

Spray-Rite was a distributor of Monsanto chemicals. Monsanto terminated the distributorship because Spray-Rite was selling at a discount to large dealers. Monsanto claimed that it terminated because Spray-Rite failed to maintain the staff of sales agents that Monsanto wanted. It is not clear why this case falls outside the protection of the Colgate Doctrine.

Business Electronic v. Sharp Electronics—1988

Sharp was (is) a manufacturer of calculators, which at this time were sold for around \$1000 to business customers. Sharp had two retailers in the Houston area, one was Business Electronics and the other was Hartwell. Hartwell complained to Sharp about BE and threatened to stop selling Sharp products unless BE was terminated. Sharp acquiesced. BE sued. The jury found for BE but the Sup Ct over turned.

There was disputed testimony about the extent to which BE may have been free riding on Hartwell. The jury decided that the facts said that Sharp terminated BE because of price cutting. However, apparently the court decided that because there was no explicit pricing directives in the contract and because there had been a lot of price cutting by both sellers that the issue wasn't just price. Hence, it was not per se illegal. Moreover, the court decided that it didn't have any anticompetitive effects since Sharp had no market power in calculators.

This case shows how crazy the court is on RPM issues.

Discussion

Miller Tydings Act of 1937 and the McGuire Act of '52 allowed for states to write fair trade laws that permitted RPM. These acts were repealed in 1975 returning RPM back to the position it held based on *Dr. Miles*. From '37 to '75, the court's sanctions against RPM seem to have hinged on conspiracy. The *Monsanto* case appears to show the return to a larger prohibition. Interestingly, Congress stepped in and directly prohibited the Justice Dept. from arguing in favor of RPM before the Sp. Ct. in the *Monsanto* case. This is indicative of a secular decline in popular opinion concerning RPM. In 1950, there were only four states (Alaska, Missouri, Texas, and Vermont) that did not have fair trade laws. By 1975, ten more states were without them, and there was lax enforcement of fair trade in the remaining 36 states.

² Klein, Benjamin, and Murphy, Kevin M. "Vertical Restraints as Contract Enforcement Mechanisms," *The Journal of Law & Economics*, October 1988, pp. 265-298.

Resale Price Maintenance — Monopoly Explanations³

RPM is the practice of manufacturers dictating the price at which their products will be sold in the retail market. It is a step beyond “manufacturer’s suggested retail price.” In RPM the manufacturer will impose penalties on wholesalers and retailers that defy the mandated price. In most cases, RPM is a barrier against price cutting as opposed to price gouging.

RPM has been explained, and condemned by the courts, as a method of monopoly cartel organization. The object of a monopoly is to limit quantity and raise price. The problem faced by a cartel is the allocation of the monopoly quantity among the cartel members and the enforcement of these quotas: Each cartel member has an incentive to cheat on the cartel agreement by marginally cutting price and increasing its output. It thus enjoys even higher profits than those afforded by the cartel arrangement.

RPM can be an efficient cartel device. Cartel members can cut price to distributors but those distributors cannot easily pass the price cuts along to consumers. Hence, the cheating cartel member’s sales do not grow; the only effect is to increase the profits of the distributor.

It has also been argued that RPM is a cartel device by monopolizing the distribution channels available to potential manufacturers. The cartel supports a RPM structure that stops competition among distributors. Distributors that break the rules are penalized (lose their rebates that come at the end of the year). Hence, distributors are not willing to handle the products of competing manufacturers.

Resale Price Maintenance -- Non-Monopoly Explanations⁴

Manufacturers often use RPM even when they are not acting in concert. Manufacturers may find RPM an efficient device for controlling the marketing of their products when:

Retailers offer services at the point of sale that are important in convincing the customer to buy the good. In this case RPM stops cut rate sellers from free riding on the sales effort afforded by full-service suppliers. This is also the reason that wholesalers do not sell to the public at wholesale prices. (Note that if the service provided with the sale can be charged for separately, as in the case of installation, then there is no problem with two tiered sales networks.)

Manufacturers do a lot of brand advertising that can be adversely affected if consumers search the market and find competing brands. Hence, if the consumer knows that Brand X cost the same everywhere, there is no reason to price shop which could lead to brand shopping and switching as a by-product.

³ Telser, Lester G. "Why Should Manufacturers Want Fair Trade?," *The Journal of Law & Economics*, October 1960, pp. 86-105.

⁴ See Telser and, also, Marvel, Howard P., and McCafferty, Stephen. "The Welfare Effects of Resale Price Maintenance," *The Journal of Law & Economics*, May 1985, pp. 363-380.

Manufacturers want to prevent loss-leader sales. If a manufacturer is trying to achieve status for its product it may not want the product to be used as a loss-leader which would cheapen the image. The manufacturer wants price and counter space to signal certification of high quality. The subtle point is that if a manufacturer needs counter space, it can buy it even for low turnover items by offering retailers high markups. However, if some retailers mark down the product the other retailers will not be able to sell the product and will not keep it on the shelf. Hence, total counter space devoted to the product falls even though the profits to the price cutting seller increase.