

Unreasonable rules and rules of reason: economic aspects of vertical price-fixing

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The truth is rarely pure and never simple.

Oscar Wilde

I. Introduction

*Monsanto v. Spray-Rite*¹ was presented to the Supreme Court as a question of the standard of proof required to find a vertical price-fixing conspiracy. Despite the Court's willingness explicitly to reverse itself with respect to non-price vertical territorial and customer restrictions in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,² it was unwilling to carry the logic of its *Sylvania* decision to vertical price restrictions in *Monsanto*.

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¹ *Monsanto Co. v. Spray-Rite Service Corp.*, 1984-1 Trade Cas. (CCH) ¶ 65,906 (Sup. Ct. 1984).

² 433 U.S. 36 (1977).

Few would argue—certainly we would not—that the effects of vertical restraints are universally benign. An increasing number of economists, nonetheless, are finding procompetitive and efficiency-inducing attributes of vertical restraints in some market circumstances. The reasoning underlying these views is well set forth in the amicus brief of the Department of Justice in the *Monsanto* case. It was the conclusion of the Department that “[t]here is no sound basis for assuming . . . that resale price maintenance is so invariably anticompetitive as to justify per se condemnation” and, further, that “the logic of *Sylvania* compels the conclusion that resale price maintenance—like other vertical restrictions—is unsuitable for per se treatment.”³

The argument in this article is not radically different from that of the Department. We proceed by noting first the legal anomaly that distinguishes between constraints realized through contracts and those achieved through ownership. Section III then surveys the competitive harms that may be caused by vertical restraints—whether arranged by contract or ownership—and the market circumstances in which such harms are likely to occur. Section IV, looking on the opposite side of the picture, considers circumstances in which vertical restraints may enhance efficiency and promote competition. While we make no effort quantitatively to assess the frequency with which benefits from vertical restraints exceed the harms, we conclude in Section V that they are frequent enough so that the position of the Court with respect to non-price restraints in *Sylvania* should be extended to price restraints as well.

Rahl observed some years ago that “The search for a shortcut to wisdom sealed in a Latin capsule ought to give way to the hunt for better understanding of the competition we revere and of the

³ Brief for the United States as Amicus Curiae, *Monsanto Co. v. Spray-Rite Service Corp.*, No. 82-914, at 6, 19. The then-Assistant Attorney General, William F. Baxter, was quite vocal in pressing for adoption of a rule of reason. In contrast, Sanford G. Litvack, Baxter’s predecessor, urged retention of per se and, in fact, criminal liability in vertical price-fixing cases.

free economic system which the Sherman Act symbolizes.”⁴ We concur. Even with per se, courts often have to analyze the factual circumstances of alleged antitrust violations if only to find “whether a given transaction does or does not fit the label.”⁵ A direct analysis of competitive effects would be the preferable procedure.

II. A digression on organizational form: contractual restraints and vertical integration

For purposes of the argument, suppose the existence of comprehensive arrangements between a manufacturer and distributors of the manufacturer’s products. These arrangements, we assume:

1. define the prices at which the manufacturer’s goods must be sold by distributors, including special sales and discounts;
2. specify which of the manufacturer’s goods must be carried by distributors;
3. preclude distributors from selling the products of other competing manufacturers;
4. determine which, if any, complementary products and services must be sold, and the terms under which such selling may occur;
5. prescribe the advertising and other sales promotion policies and practices of distributors;
6. set detailed distributor inventory requirements for various product lines and replacement parts;
7. dictate conditions of employment for distributors, including training and experience requirements, wages, hours, benefits programs, reasons for dismissal, etc.;

⁴ James A. Rahl, *Per Se Rules and Boycotts Under the Sherman Act: Some Reflections on the Klor’s Case*, 45 *VIRGINIA LAW REVIEW* 1174 (Nov. 1959).

⁵ *Id.* at 1173.

8. determine days and hours during which the outlets will be open;
9. govern the physical appearance of the distributors' facilities and the conditions under which they will be expanded, modified, or altered, including closings and relocations;
10. assign geographic territories to the respective distributors;
11. dictate from whom banking, legal, and accounting services are to be obtained;
12. require use of defined accounting, billing, and collection records and procedures; and, for good measure,
13. set up a system for cost, revenue, and profit sharing between and among the manufacturer and the distributors.

The comprehensiveness and restrictiveness of such vertical arrangements, it seems clear, would impose far greater restraints than those found in typical distributorship agreements. The first impression one might have is that they are obviously per se unlawful under the standards of *Dr. Miles*, *Monsanto*, and all of the intervening cases. There are no existing defenses. Yet this need not be correct. The described restraints amount to nothing more than the internal working arrangements of a vertically integrated firm.

Is there plausible economic reason to believe that *contractually* arranged restraints among separate firms almost invariably have anticompetitive effects while similar restraints—perhaps much more effective restraints—achieved through *ownership* integration do not? Hardly. In fact, the decision in *Dr. Miles* may have been based as much on the premise that resale price maintenance unreasonably limits “the freedom of trade on the part of the dealers who own what they sell”⁶ as on its more frequently noted holding that the effects are the same as those of a horizontal agreement among the same set of dealers.⁷ But

⁶ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 407-08 (1911).

⁷ A clearly stated per se rule for even horizontal price-fixing cases had yet to appear in 1911. The rule of reason was, of course, adopted by the Court in the same year in *Standard Oil Company v. United States*,

whatever the history, the law now uses a different standard for what may be no more than different organizational and legal forms for achieving more or less the same results.

III. Vertical relations and adverse competitive effects

It is seemingly undisputed that neither vertical integration nor contractually arranged restraints pose any competitive threats if competition prevails at all stages of production and distribution. That is, if all markets from those for factors of production through those for final products are structurally and behaviorally competitive—in the old sense—or effectively contestable—in the newer jargon—there need be no competitive concern about the manner in which successive layers of transactions are organized. In these circumstances, no seller can be preempted from entering at any stage with any combination of price and non-price product attributes that seller thinks will be profitable.

There are two reasons why little comfort can be found in this analytic fact, however. First, one of the purposes of establishing vertical restraints may be to eliminate competition or reduce market contestability.⁸ Second, there is no obvious reason save increased efficiency for vertical restraints to exist unless some degree of market power—some competitive imperfections—are also present. The latter may be created by the vertical restraints or the restraints may be but a symptom of preexisting power.

The most obvious way that vertical restraints can be used to create market power when none has previously existed is through their use in establishing and administering a cartel (or monop-

221 U.S. 1 (1911). Justice Holmes, in dissent in *Dr. Miles*, opined, “I see nothing to warrant my assuming that the public will not be served best by the company being allowed to carry out its plan. . . . I cannot believe that in the long run the public will profit by this court permitting knives to cut reasonable prices for some ulterior purpose of their own. . . .” 220 U.S. at 412.

⁸ Unless it is otherwise clear from the context, vertical restraints will hereinafter incorporate those arising from either vertical integration or vertical contracting.

oly).⁹ At the extreme, if every seller of substitute goods at every stage of production and distribution has binding and enforceable resale price covenants, it takes only a single horizontal agreement among the sellers at any stage to eliminate completely price competition among all of the firms. Potential entry by new firms may limit the market power thus created, but market power would be created, nonetheless. To the extent that the group acts in unison, the vertical restraints—superimposed on effective horizontal restraints at some stage—permit forms of conduct predicated on market demand elasticities rather than on the higher demand elasticities each firm would perceive in the absence of the restraints.

It is impossible here to recount in detail the market factors that make effective cartelization of this sort feasible. But, the smaller the number of firms at each and at any stage, the more homogeneous the product, the more similar are the firms at each stage, the higher are the barriers to entry at each stage, and the more stable is the demand for the final product, the easier ought it be to subdue intragroup competitive tendencies.¹⁰ And the more price inelastic is the market demand for the final product, the greater is the incentive to collude.

⁹ See B. Yamsey, *Origins of Resale Price Maintenance*, 62 *ECONOMIC JOURNAL* 522-45 (1952); J. R. Gould & L. E. Preston, *Resale Price Maintenance and Retail Outlets*, 32 *ECONOMICA* 302-12 (1965); A. McLaughlin, *An Economic Analysis of Resale Price Maintenance* (1979) (Ph.D. dissertation, UCLA); and R. A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 *UNIVERSITY OF CHICAGO LAW REVIEW* 1-20 (1977). The literature related to this point and to the remainder of the discussion is voluminous and repetitious. A reasonably comprehensive, categorized bibliography is available from the authors.

¹⁰ For a more complete discussion, see A. Phillips, *A Theory of Interfirm Organization*, 74 *QUARTERLY JOURNAL OF ECONOMICS* 602-13 (1960), and *MARKET STRUCTURE, ORGANIZATION AND PERFORMANCE* (1982). There is an excellent discussion of the difficulties involved in reaching effective horizontal agreements in O. E. Williamson, *MARKETS AND HIERARCHIES*, 234-47 (1975).

It is difficult to generalize with respect to the stage at which cartelization efforts are most likely to occur. Instances exist in which strong horizontal rivalry in the distribution stages gave rise to industry-wide wholesale and/or retail trade associations. The latter, perhaps because of their ineffectiveness in mitigating competition among their own members, then may have addressed pleas (or threats) to manufacturers to do through vertical contracting what the trade associations could not themselves do through horizontal agreements.

Instances also seem to exist, however, in which the impetus for the collective and anticompetitive use of vertical restraints arose among manufacturers. Tenuous horizontal restraints at that level can be rendered less fragile through resale price maintenance. If, for example, a few retailers—for their own purposes—lower the prices of one manufacturer's products, other retailers may pressure the manufacturers of substitute products to "cheat" on a horizontal agreement or to break a competitive détente. Vertical agreements arranged even separately by the manufacturers may reduce the proclivity of distributors to behave independently with respect to downstream prices and, further, may establish a mechanism for detecting and for punishing those who engage in such behavior.

At the same time, vertical price restraints, together with other covenants with respect to resale, can make viable a discriminatory pricing system that would otherwise invite arbitrage.¹¹ Such an effect, however, depends not only on preventing arbitrage in the focal good; it depends likewise on the unavailability of a close substitute from other sellers in the more attractive markets. Entry

¹¹ See W. S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 *UNIVERSITY OF CHICAGO LAW REVIEW* 825-73 (1955); R. E. Caves, *Vertical Restraints as Integration by Contract: Evidence and Policy Implications*, Harvard Institute of Economic Research Discussion Paper No. 754 (Apr. 1980); R. H. Bork, *The Rule of Reason and the Per Se Concept: Price and Market Division II*, 75 *YALE LAW JOURNAL* 373-475 (1966); R. Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 *COLUMBIA LAW REVIEW* 1-38 (1978); and L. J. White, *Vertical Restraints in Antitrust Law: A Coherent Model*, 26 *ANTITRUST BULLETIN* 327-45 (1981).

into those markets must somehow be barred, and this cannot ordinarily be accomplished by resale pricing agreements alone. It is in circumstances such as these that resale pricing restraints seem more a symptom than a cause of monopoly.

Finally, vertical pricing arrangements—usually in conjunction with non-price covenants—may be used to “foreclose” potential or actual competitors. This is likely to occur only where full vertical integration is an inefficient organizational arrangement and where, at some point in the vertical hierarchy, single firms deal with several upstream (or downstream) suppliers (or buyers). Adam Smith’s pin factory, for example, sold completed pins to, we assume, wholesale and retail dry goods and related types of outlets. We suspect that further forward vertical integration by the pin factory would have been inefficient were it to involve only pins and that pins, in fact, constituted a minute part of the sales of efficiently organized dry goods wholesalers and retailers.¹²

Now the downstream distributors could enter an agreement restricting them to sell only the pins of Smith’s pinmaker, with further agreement that these would be sold at fixed prices. Competing pinmakers, like Smith’s fellow, would not find it feasible to enter distribution, but the exclusive contracts *and* their price restrictions would not have overtones of a monopoly problem unless Smith’s pinmaker snared many of the distributors in his net of contracts. Again, without another source of monopoly power—here power to exclude—the use of vertical restraints by single sellers is unlikely to present a monopoly problem.¹³

¹² Analogous reasons would have made backward integration into iron and steel manufacturing unattractive to the pinmaker and—probably—forward integration by iron and steel makers into pins.

¹³ The parallel use of such restraints by *all* sellers is, of course, a different matter. Effective agreements with that consequence may be the source of monopoly power—if entry is somehow thwarted. As Williamson has pointed out, information impactedness (e.g., the entrant knows he is qualified; the bank does not) coupled with a tendency for poor risks opportunistically to exaggerate their qualifications and with imperfect labor markets (e.g., incumbent firms’ workers have an experience premium behind the cost disadvantages of otherwise qualified

It is conceivable that contractually arranged pricing could be used predatorily to squeeze out competitors at one or another level. It has been charged that partially vertically integrated firms have priced with this purpose and effect; contracting might be implemented similarly. But once more, monopoly power would be a necessary precondition.

IV. Efficiency and vertical restraints

That monopolistic preconditions may exist, that vertical restrictions may be symptomatic of these conditions, and/or that vertical restrictions used in combination with horizontal restraints may create monopoly power ought not lead to the conclusion that the net effect of such restraints is always socially harmful. A salient but often ignored fact about markets is that, with “perfect liberty”—Smith’s term for free entry—organizational forms for transacting as well as prices and product characteristics should tend toward those most harmonious with efficiency and consumer interests.¹⁴ To the extent that this is true, restraints on transactions may lead to greater efficiency.

In this view, it has long been recognized that inefficiency results from market-mediated vertical linkages among firms that are less than purely competitive. The reasoning is simple. Efficiency requires that payments for intermediate goods by each successive firm in a vertical chain be at values equal to the sum of

vertical contracting can be seen as transacting modes that may increase capital-cost entry barriers. However, the failure of firms to enter (and the failures of entering firms) can often be explained on grounds other than the anticompetitive effects of vertical restraints. This point will be developed below. Moreover, even if the barrier to entry issue is operative, the efficiency-enhancing properties of the restraints may outweigh anticompetitive effects.

¹⁴ Markets may fail to be efficient for other reasons, however. In particular, scale or scope economies that give rise to natural monopoly and consumer or producer externalities remain as causes of market failure whether or not individual producers and consumers optimize in their own best interests.

the accumulated factor costs up to that point in the chain. That is, the price at each stage should equal the marginal cost of the most efficient firm at that stage. If this is not true—if at any stage there is a degree of monopoly such that price exceeds marginal cost—there is what amounts to factor price distortion. All subsequent production is technically inefficient in the sense that, whatever the output, there is an alternative way to produce it at lower costs.¹⁵

Vertical integration is one possible way of reorganizing production to realize the more efficient way of valuing intermediate transactions. Internal transfer prices for the vertically integrated firm can be denominated at marginal cost, with consequent lower costs and higher profit for the integrated enterprise. If the integration in no way affects demand for the firm(s) at the final stage, prices will be lower and output will be higher.

In some market contexts, vertical price-fixing may be used as a substitute for vertical integration for the same purpose. Or, almost the same thing, the vertical price-fixing may be a mechanism for sharing profits among successive, bilaterally monopolistically related firms in a way conducive to their participating at activity levels more or less analogous to those of a vertically integrated firm.

But then why not vertically integrate? The question brings us away from classical economics and theories in which price is usually taken as a sufficient statistic for mediating transactions, where information is free and knowledge is nearly perfect. More realistically, those engaged in transacting have bounded rationality.¹⁶ That is, their knowledge is imperfect, information is costly

¹⁵ See S. WEINTRAUB, *PRICE THEORY* (1949); R. D. BLAIR & D. L. KASERMAN, *LAW AND ECONOMICS OF VERTICAL INTEGRATION AND CONTROL* (1983).

¹⁶ The discussion here relies heavily on the contributions of Oliver E. Williamson, especially *Markets and Hierarchies* (*supra* note 10). In addition, see his *The Vertical Integration of Production: Market Failure Considerations*, 61 *AMERICAN ECONOMIC REVIEW* 112-23 (May 1971); *Markets and Hierarchies: Some Elementary Considerations*, 63 *AMERICAN ECONOMIC REVIEW* 31-46 (1973); *Transaction Cost Economics:*

to obtain, the number of relevant factors to be considered is large, the future is uncertain in important (but unspecifiable) dimensions, and the interrelationships among the many influences on market outcomes are complex. Add to this so-called information impactedness (or information asymmetries) among the parties. Different individuals possess different information and there are both time and money costs involved in reducing these asymmetries. Too, transactions require investments in human and physical capital that at least to some degree entail transaction-specific sunk costs. Failure to realize benefits from the specific transactions for which such investments are made leaves the investing party with no nearly equivalued alternative.

In such a world spot markets and, indeed, term contracts with one or more parties obligated to perform in the future suffer from serious limitations. In fact, where these characteristics abound, transactions tend to be accomplished *internal* to a firm rather than by contracts among separate firms. What we have are the successive stages of Smith's pin factory, with work moving from the drawing of wire, to wire cutting, to the sharpening of pins, . . . , to boxing and shipping without the use of market-mediated exchanges. The firm manages transactions by fiat, adapting its decisions sequentially through time to reflect new circumstances and new information.

There is more to transactions cost, however, than simply supply-side considerations. Buyers at each stage, including particularly final consumers, also have transactions cost. So—although this obviously varies with the type of good involved—

The Governance of Contractual Relations, 22 *JOURNAL OF LAW AND ECONOMICS* 233-61 (1979); and, with M. L. Wachter & J. G. Harris, *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 *BELL JOURNAL OF ECONOMICS* 250-80 (Spring 1975). See also, V. P. Goldberg, *The Law and Economics of Vertical Restrictions: A Relational Perspective*, 58 *TEXAS LAW REVIEW* 91-129 (1979); A. Phillips, *Schwinn Rules and the 'New Economics' of Vertical Relations*, 44 *ANTITRUST LAW JOURNAL* 573-80 (1976); B. Klein, R. G. Crawford & A. A. Alchian, *Vertical Integration, Appropriate Quasi-Rents and the Competitive Contracting Process*, 21 *JOURNAL OF LAW AND ECONOMICS* 297-326 (1978).

consumer demand becomes a function of many variables other than price. Clear candidates are such things as durability, postsale service, maintenance, and other time and money costs borne by purchasers. It is not only the quantities of these things that affect sales, but also the certainty that a purchaser may have with respect to the conditions and terms under which they will be available. Retail buyers of complex and novel products often suffer acutely from bounded rationality and information impactedness.

These characteristics of demand lead suppliers to respond. Costs are incurred for altering product quality, not necessarily for the best (or worst) quality, but rather for that which in conjunction with other variables is seen by the supplier as optimal. In the same way, sellers may alter the number of outlets, with more outlets being associated with lower time and travel costs for customers. Sellers may require outlets to carry inventories, to maintain and service products after sale, to provide information and education to customers, to participate in coordinated advertising and sales promotion programs, and so forth.

The way the several selling factors interact with one another on the demand side may be very complex and very critical to a seller's success. Thus, price demand elasticity may vary with customers' time costs in buying (and, hence, number of outlets and number of store personnel).¹⁷ Assurance that there is a coincidence between perceived and actual non-price attributes of the good may be of great relevance to buyers.

It is here that the free-rider problem enters. Given *all* other relevant factors—the availability of information, assurances of product quality, availability of postsale service, nearby sales and service outlets, trained personnel—any customer would prefer a lower to a higher price. This often places a given outlet in a position to maximize its returns by simultaneously lowering its

price below those needed to cover the full costs of distribution and letting its customers rely on the other outlets for the cost-increasing, ancillary services. This, of course, easily leads to a breakdown in the entire scheme of distribution, since those offering the full services suffer sales losses and have no means to recover their higher costs.¹⁸

In the case of a multiproduct firm, the price and non-price attributes of several goods may require coordination of a sort that leads to price increases rather than price cutting by the free riders. Consider, for example, a newspaper that “produces” news and advertising, with a circulation price (per paper) and an advertising price (per column inch). The demand for advertising depends on the paper's circulation which, in turn, is a function of circulation price. Lowering the latter, even to levels below the marginal cost of circulation, would be profitable up to the point that increased net revenues from advertising at least offset decreased net revenues from circulation. An independent distributor, whose only function is to sell papers, would not see the revenue offset from advertising. The distributor gets gains from increasing the circulation price subscribers pay up to the point that the marginal revenue from selling papers—only papers—is equal to the marginal cost of obtaining papers. Thus, newspapers—even reasonably competitive newspapers—may contractually set circulation price maxima. If such contracts are unlawful

¹⁸ There is a growing literature in economics on the so-called principal-agent problem. The literature deals largely with the types of contracts and structural circumstances that do (or do not) lead to the agents behaving in ways that conform to the interests of the principal. See, e.g., S. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 *AMERICAN ECONOMIC REVIEW* 134-39 (1973); B. Holmstrom, *Moral Hazard and Observability*, 10 *BELL JOURNAL OF ECONOMICS* 74-91 (Spring 1979); S. Shavell, *Risk Sharing and Incentives in the Principal and Agent Relationship*, 10 *BELL JOURNAL OF ECONOMICS* 55-73 (Spring 1979). On the free-rider problem, see V. P. Goldberg, *Resale Price Maintenance and the FTC: The Magnavox Investigation*, 23 *WILLIAM AND MARY LAW REVIEW* 439-500 (1982); T. H. Silcock, *Some Problems of Price Maintenance*, 48 *ECONOMIC JOURNAL* 42-57 (1938); and L. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 *JOURNAL OF LAW AND ECONOMICS* 86-105 (1960).

¹⁷ Consumers with high alternative costs for time will, for efficiency reasons, be willing to make larger money expenditures in order to reduce the time costs of consumption. See G.S. Becker, *A Theory of the Allocation of Time*, 75 *ECONOMIC JOURNAL* 493-517 (1965); and S. B.

or otherwise unenforceable, vertical integration into the circulation activity may become attractive.¹⁹

It was emphasized in Section III that the use of vertical restraints may be symptomatic of monopoly power or, when used collusively, the means for creating that power. There is little about transactions costs analysis that lessens the relevance of these facts. What transactions costs analysis does do, however, is expand the menu of circumstances in which efficiency depends on there being restrictive covenants in contractually based exchanges.

With some exaggeration, resale price maintenance can be seen as two exchanges. In one—the obvious one—goods flow downstream toward the market. In the other, downstream distributors sell back to manufacturers a defined set of services that the latter see as important ancillary ingredients to market success. The “price” received by the distributors for rendering these services is their gross margin, the difference between the agreed-upon retail price at which they sell and the wholesale price at which they buy. When they fail to render the service, the manufacturer may opt no longer to contract with them, and both exchanges are terminated.²⁰

V. Conclusion—a proposed rule of reason

It appears to us that the circumstances in which price and non-price vertical restraints are efficient substitutes for vertical integration are neither rare nor of trivial importance. Indeed, without lawful vertical restraints, it is probable—although the

¹⁹ It is difficult to assess the extent to which vertical integration has been fostered because of the “inhospitable tradition” of the courts toward contractually established vertical restraints. If there is such a reaction, and if integration poses more effective barriers to entry than those arising from contracting, positive reasons appear for not condemning the contracts.

²⁰ See V. P. Goldberg, *The Free Rider Problem, Imperfect Pricing and the Economics of Retailing Services* (1983) (unpublished manuscript).

hypothesis is largely untestable—that some goods for which consumers are willing to pay in excess of the costs of production and distribution may fail to find their way to consumers. There is, on the other hand, the danger that vertical restraints will themselves be used to the detriment of consumers—that they will aid in the formation and operation of horizontal collusive arrangements, increase barriers to entry, retard the introduction of innovative and efficient distribution systems, and needlessly spawn various sorts of cost-increasing, non-price competition.

Individual cases involving vertical restraints will clearly have to be considered on their own merit with a rule of reason approach. That does not mean, however, that there are no general considerations. The overriding factors to be investigated concern whether the restraints operate effectively to bar the entry of new producers of essentially similar goods or services, to foreclose the market to producers of new goods or services, or to inhibit the introduction of new modes of distribution. That is, the restraints ought not serve substantially to reduce the extent to which markets are contestable—contestable through the innovative behavior of incumbent firms or by the entry of new firms.

If the number of participants at each stage is “substantial,” with no participant at any stage having a “very large” market share, and if there is no interfirm organization (e.g., trade association) the demonstrable effect of which is to reduce contestability, there is no obvious way that vertical restraints adopted and enforced by a single manufacturer and related distributors can be harmful. When, however, all or most (interchangeable) products are distributed with substantially similar price and non-price vertical restraints, the relevance of the number of participants is diminished and that of possible interfirm organizational influences is increased.

If the number of firms at any stage is small—essentially duopolistic or oligopolistic structure at that stage—vertical restraints may more easily operate to foreclose that stage from potential upstream suppliers or potential downstream buyers. Restraints here may also be used to “harmonize” the conduct of both upstream and downstream firms in a way that creates an

effective anticompetitive interfirm organization at all stages. The simple fact of a small number structure at any stage need not, however, mean that contestability is absent.

Product characteristics are also important. In circumstances in which customers at all stages can in fact use price as a sufficient statistic for transactions, the incentive for sellers to collude and the ability of sellers effectively to collude are enhanced. That is, where products are largely undifferentiated and undifferentiable and where differences among sellers in terms of sale other than price are of little importance to customers, it is not clear that the purpose of vertical restraints can be anything other than anti-competitive. Care is necessary in treating differentiation, nonetheless; differences in the time and money costs of transactions to consumers may make for important differentiation.²¹

Conversely, where presale and/or postsale services are important to consumers, vertical price and non-price restraints ought not be suspect if there are other near-substitutes available at all stages and/or if entrants employing different price, non-price selling strategies are not precluded by the restraints. Here the size distribution of firms may be of some consequence. The de facto effect of vertical restraints imposed by a firm with, say, at least 75 percent of the market (at all stages) is likely to be different from that of a firm with no more than 5 percent of the market (at any stage).

Another consideration in reasonableness tests is the possibility of important interrelationships among price and non-price variables in the demand functions for the relevant goods. The independencies between newspaper circulation and advertising rates were noted above. There an upstream producer of two separate but demand-related products might impose a maximum price restraint on a downstream seller of only one of the products. For much the same reason, an upstream producer of a single product—denim jeans, perhaps—might have procompetitive reasons

for setting price maxima for downstream sellers of many lines of denims and other types of clothing.

We end where we began. Per se rules—if indiscriminately enforced—may cause a good deal of mischief. Wisdom cannot be found in a capsule of Latin words. Truth is rarely pure and never simple.

²¹ Rattlesnake bite serum available in a week is not a good substitute for the same serum available in a few minutes.