Office of the Attorney General
Washington, D. C. 20530

MEMORANDUM TO: The Cabinet Council on Legal Policy

FROM: William French Smith
Attorney General

SUBJECT: Antitrust Issues to be Discussed at Our Meeting on Thursday, March 24, 1983

In addition to our proposed antitrust legislative reforms (discussed in a separate memorandum), the Agenda for this Thursday's meeting of the Cabinet Council on Legal Policy will include discussions of antitrust policy issues concerning (1) resale price maintenance and (2) the liability of municipalities under the antitrust laws. This memorandum provides background for discussion of these latter two subjects.

1. Resale Price Maintenance. Resale price maintenance (RPM) is a practice by which sellers limit the prices that their customers (and sometimes the customers of those customers) may charge when reselling their products. It may take the form of minimum RPM (where the limit is a price floor), maximum RPM (where the limit is a price ceiling), or the seller may establish a particular resale price from which the customer is not free to deviate.

All types of RPM are presently illegal per se under the antitrust laws. As such, they are held unlawful without consideration of their possible procompetitive effects. While the Supreme Court in recent years has moved away from per se condemnation of other seller-imposed restrictions on buyers, particularly in its decision in Continental T.V., Inc. v. GTE Sylvania, Inc., 1/ it has yet to relax the per se rules it has created against RPM.

Since this Administration took office, the Department of Justice has pointed out the extent to which these judicial rules are overly restrictive. The Department has stated its intention

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1/ 433 U.S. 36 (1977).

to challenge the practice under the antitrust laws in circumstances in which it actually restrains competition. But in briefs filed as amicus curiae, in testimony before Congress, and in other public comments, the Department has pointed to the possible procompetitive effects of RPM, and the difficulty of distinguishing it from other "vertical" arrangements between manufacturers and their distributors. We have argued that RPM and other, nonprice vertical arrangements are sufficiently similar in their basic competitive characteristics that RPM activities, too, should be analyzed under the rule of reason. The Supreme Court recently granted certiorari in a case (Monsanto Company v. Spray-Rite Service Corp.) in which the Department, as amicus, has recommended to the Court that it fully reexamine the legal status of resale price maintenance. The Department's legal and economic arguments regarding the competitive merits of RPM were set forth in substantial detail in a letter from Assistant Attorney General Baxter to Congressman Robert McClory in June of 1982, and I have enclosed a copy of this letter for your convenience.

Briefly, a manufacturer may wish to employ RPM so that retailers will market his product in ways that the manufacturer desires. By setting the retail price sufficiently above the retailer's wholesale cost, the manufacturer may induce the retailer to provide a wide variety of point-of-sale or promotional services, such as more intensive local advertising, more knowledgeable and highly trained sales personnel, and quicker and more expert repair services. All of these services may increase sales and intensify interbrand competition.

The question arises why retailers will not increase services unilaterally (even without RPM) if more sales would result. The problem is that if some but not all retailers offer more services, some, perhaps most, of the increased sales that result may be made by those who offer lower prices because they offer no services. Thus, a substantial number of customers may go to the higher-priced outlet, consume the time of sales personnel in order to obtain the appropriate counseling, but then purchase from a low-cost, low-priced outlet, which ultimately forces all dealers to reduce or drop services. This is referred to as the "free-rider" problem.

If the manufacturer is to be successful in increasing his sales by affecting the manner in which his distributors market his product, he must be able to shelter the profit margins of cooperative distributors from free riders. For this reason, he may wish to impose RPM on all dealers. Such arrangements can promote competition and consumer welfare, and are clearly not of the category of covert cartel practices (e.g., bid rigging) that should be subject to a rule of per se illegality.

It is important to note that in the Sylvania case, the Supreme Court viewed the free-rider problem as justifying the imposition of reasonable nonprice vertical territorial and customer restraints. A manufacturer may impose such restraints precisely for the purpose of protecting his distributors from certain types of intrabrand price competition that the manufacturer considers harmful and adverse to intense promotion of his product in competition with other brands. This analysis indicates the logic of treating RPM as other vertical arrangements are treated under the antitrust laws, under the rule of reason.

2. Municipal Liability. Under the "state action" doctrine, competitive restraints imposed by a state as sovereign are immune from the federal antitrust laws, if the state has clearly articulated and affirmatively expressed a policy to limit competition and has provided for active state supervision. Municipalities may be eligible for such a state action exemption, but only where the state has authorized or directed their conduct pursuant to such a state policy. The Supreme Court held in its 1978 City of Lafayette decision 2/ that municipalities are not equated with states for antitrust purposes, and may not claim a state action exemption in the absence of a state policy to limit competition. The Court's 1982 Boulder decision 3/ established that home-rule municipalities are not exempt from that standard and, like other municipalities, must base any claim for state action immunity on a clearly expressed and actively supervised state policy.

Local government officials have expressed serious concerns that fear of antitrust treble-damage liability could inhibit the performance of legitimate governmental functions. They fear that the City of Lafayette and Boulder rulings could require state legislatures to prescribe municipal policy in detail in order to avoid antitrust liability. Many state officials, on the other hand, have opposed granting subordinate governmental entities antitrust immunity in the absence of a state policy to limit competition.

There have been a number of proposals for legislation affording antitrust immunity to municipalities in the wake of City of Lafayette and Boulder. One such proposal, favored by associations of municipalities, would simply equate the actions of local governments with those of the states for antitrust purposes. Other proposals would go further and alter the complex

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2/ 435 U.S. 389 (1978).

3/ Community Communications Co. v. City of Boulder, 455 U.S. 40 (1982).

state action doctrine itself, as that doctrine has evolved in several recent Supreme Court decisions. Each proposal has presented its own set of difficult legal and policy issues. The Administration probably will be asked for its views on legislation in this area during the current Congress.

Although the concerns of local governments are serious ones, it is not clear that the Boulder decision requires a special antitrust exemption for municipalities beyond the scope of the state action exemption. It is important to note that the Supreme Court did not hold in Boulder or City of Lafayette that the city had violated the antitrust laws. The Court emphasized in Boulder that it was dealing only with antitrust immunity, and specifically suggested that a "flexible" approach to the question of actual liability would probably be appropriate. Thus, the normal conduct of municipal affairs, including the purchase or provision of municipal services, may well be found by the courts to present no serious substantive antitrust concerns. The Court also emphasized, as the plurality had in City of Lafayette, that it was not reaching the question of what remedies might be appropriate if municipal conduct were found to constitute an antitrust violation. Finally, the Court repeated in Boulder the standard articulated by the plurality in City of Lafayette, which requires only that anticompetitive municipal conduct be "authorized or directed" by the state to qualify for state action immunity. The plurality in City of Lafayette explained that its holding did not mean that a city "necessarily must be able to point to a specific, detailed legislative authorization" before it may assert a state action exemption.

These factors have led the Department of Justice to question the need for legislation in this area at this time. The Department is keeping abreast of developments and continuing to study the issues.

Enclosures