Maintenance of Resale Prices

Paul L. Sayre
Indiana University School of Law

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Among the legal problems relating to the distribution of commodities, none has received more attention during the past few years than that of the maintenance of resale prices. Various bills have been introduced in Congress for the purpose of legalizing price fixing by the producer. At the same time the courts and the Federal Trade Commission have been trying to establish some definite policy. The rights of patentees, and the fact that combination has been present in many cases, has further complicated the problem.

Price maintenance is the term applied to that marketing policy, which consists of the imposition by the producer of restrictions upon the price at which an article identified by brand, trade mark, copyright or patent may be resold by dealers. Note that price maintenance as used here refers only to identified goods.

My thesis is that the doctrine of the United States Supreme Court on the maintenance of resale prices is unwarranted.

Owing to the immensity of the question and the great number of decisions, it will be impossible to exhaust the subject in this limited discussion. I shall deal chiefly with decisions of the federal courts for several reasons: These questions usually arise in interstate or foreign commerce, which gives the federal courts jurisdiction, the federal statutes which make restraints of trade and monopoly a misdemeanor give the federal courts a jurisdiction where frequently there would be no ground for action in the state courts; furthermore, the Federal Trade Commission investigates cases of unfair competition and restraint of trade on its own initiative and appeals are taken in the circuit court of appeals. The result of all this is to make the jurisdiction of the federal courts paramount.

The methods used by manufacturers and producers of identified goods, to maintain resale prices, fall into four

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* Winning argument in the Hilton prize contest.
** Second year law student, University of Oregon.
1 The Stevens bill and the Kelly bill.
2 A good discussion and collection of authorities will be found in 7 A. L. R. 449, 19 A. L. R. 925, and 32 A. L. R. 1087.
groups, namely: the rebate, agency, contract, and boycott methods. This grouping is the one generally recognized by the courts. By the rebate method the producer sells his product to the dealer at a price so high that the dealer cannot make any profit if he sells at the indicated price. But if he sells at the indicated price he is entitled to a rebate or bonus which in the end yields a good return. Such contracts have never been held illegal and have been affirmatively enforced in a number of cases.  

Many of the large manufacturers maintain their own system of distribution and thereby control the resale prices of their product. The dealers are constituted agents of the manufacturer. When the relation of principal and agent exists, it has been held that there is no illegality in the fact that the manufacturer fixes the price at which his sales agent must sell.  

The contract system presents more difficulties. Contracts often create combinations and restraints of trade other than the fixing of resale prices. It is, therefore, difficult to say in many cases whether the price fixing element was in itself considered illegal. Prior to 1911 there were no cases holding that price fixing agreements of themselves were bad, whereas a number of cases upheld such agreements. It is true that some of these cases involved questions of patents and copyrights, but it has since been held that the owner of a patent or copyright has no better right to make restrictions on the sale of his article than any other manufacturer. In 1911 the United States Supreme Court in *Miles v. Park* held that an agreement to fix resale prices was illegal, and since then the federal courts have followed that decision.

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8 Whitwell v. Continental Tobacco Co., 125 Fed. 454 (1903); Clark v. Frank, 17 Mo. App. 602 (1885); In re Greene, 52 Fed. 104 (1892).  
10 Bement v. National Harrow Co., 186 U. S. 70 (1902); Fowle v. Park, 131 U. S. 88 (1889); Dr. Miles Medical Co. v. Goldthwaite, 133 Fed. 794 (1904); Jayne v. Loder, 149 Fed. 21 (1906).  
12 220 U. S. 373 (1911).  
13 Waltham Watch Co. v. Keene, 202 Fed. 225 (1913); Kellogg Toasted Corn Flake Co. v. Buck, 208 Fed. 383 (1913); U. S. v. Kellogg Toasted
The other method employed is what is sometimes called the boycott. The manufacturer suggests prices and refuses to sell to those who will not adhere thereto. In *United States v. Colgate & Co.*, this method was held legal by the United States Supreme Court. Three years later the Supreme Court in *Federal Trade Commission v. Beech nut Packing Co.* modified their ruling made in the *Colgate* case. In the *Beech nut* case it was held that although a manufacturer may refuse to sell, he cannot through salesmen, other dealers, or special agents, gather information about price cutters and maintain a black list of persons to whom he will not sell. It appears from these decisions of the United States Supreme Court that a manufacturer at the present time cannot contract with his dealers to resell his product at a stipulated price, nor may he employ an active boycott in attaining that end. Unless he can maintain an agency system, which small producers cannot do, or a rebate system or the boycott method so far as it is legal, he is powerless to fix the resale price of his article.

The question is whether the doctrine of the Supreme Court as enunciated by these decisions is warranted. An examination of the *Miles* case, which is the fountain head of this doctrine, will present the points of controversy. This case involved a series of contracts which had for their purpose the fixing of resale prices on certain unpatented medicines. The majority opinion was written by Mr. Justice Hughes, and a strong dissenting opinion was written by Mr. Justice Holmes. I interpret Mr. Hughes' argument as based on two grounds: first, that a price fixing agreement violates the rule against restraints on alienation, and second, that it is an unlawful restraint of trade.

Assuming then that our contract to maintain the indicated price is otherwise a good and valid one, is it a restraint on alienation? Is the dealer hampered in passing good title to the purchaser? It is evident that there is no reversion in the manufacturer. He cannot reclaim his product if the price fixing agreement is violated. The right

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9250 U. S. 300 (1919).
10 257 U. S. 441 (1922).
is only a personal one growing out of the breach of contract. He may get rights against the dealer, or against one who interferes with that right, but that does not affect the free alienability of the article. As Mr. Justice Holmes said, it is borrowing a principle from another field of law and applying it where it does not belong.\textsuperscript{11}

Even though the contract does restrain alienation, it is not necessarily fatal if we apply the doctrine of restraint on alienation in its entirety. Restrictive covenants, which restrain the alienation of land, are valid if the restriction is reasonable both in respect to parties and to the public. If the vendee of land covenants not to carry on a certain business which would injure the vendor's use of the adjoining land, then the covenant is generally enforced. Moreover, a manufacturer may require that his product be resold in the original carton or package and no objection is made to the restriction on alienation. It is deemed necessary to allow such restrictions in order to protect the producer's good will. Is it not just as necessary to protect the manufacturer against a price-cutter who preys on good will?

The second point is that in which Mr. Hughes attacks price fixing agreements as being an unlawful restraint of trade. An analysis of the reasoning and a study of monopolies will disclose a fallacy in the argument and show where the conclusion is erroneous. Economists for certain purposes classify monopolies as vertical and horizontal.

Horizontal monopoly is the union under single management of a number of enterprises of the same sort. It is based on the control of the supply of a given article which brings into play an unnatural force which may be exerted for the purpose of boosting prices. The dangerous element is the power which it affords and which is not one of the natural laws of competitive business. This form of organization or monopoly has been almost universally condemned.

Vertical monopoly refers to the control of the successive steps in the production and distribution of a given article. In that manner Henry Ford has built up one of the greatest vertical monopolies that has ever been known. He controls his product from the mine and forest direct to the consumer. But has competition in the automobile

\textsuperscript{11} \textit{Miles v. Park, supra}, note 7.
industry been lessened? It has had exactly the opposite effect. This form of organization has increased efficiency and competition to the nth degree. It is difficult to see where this form of monopoly is injurious. We have only to look about us to see that vertical monopolies built on the idea of combining manufacturing and distribution are in universal use because it makes for efficiency. Some control the distribution directly, some through agents, some through rebate systems and some through a boycott system. It is only fair to the small manufacturer who is not able to use these other methods that we should allow him to get the same results through price fixing agreements.

Let us see if Mr. Hughes considered this view of the question. He says, as regards restraint of trade:18 "As to this, the complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other."

It is evident from this statement that Mr. Hughes recognized the difference between vertical and horizontal monopoly and endeavored to bring this case under the latter. His argument was this: A combination of dealers to set prices is illegal. Such combination is in the form of horizontal monopoly and is admittedly bad. He then says that complainant achieved the same result with his series of contracts and that because the contracts obtained the same result as the combination of dealers they are likewise illegal. This does not necessarily follow. Every successful maintenance of resale prices is not illegal, for the courts have allowed price maintenance by the rebate, agency and boycott methods.

The Supreme Court doctrine is not that resale price maintenance is bad, but that contracts to maintain resale prices are illegal. Mr. Hughes' argument goes too far. It is in conflict with the adjudications upholding resale price maintenance by the agency, rebate and boycott methods.

In holding resale contracts void, the courts have based their decisions on both the common law and the statutes. In 1890 Congress passed the Sherman Anti-Trust Act,

18 Miles v. Park, supra, note 7.
which declared monopolies and restraints of trade a misdemeanor and extended the jurisdiction of the federal courts. The Clayton Act and the Federal Trade Commission Act passed in 1914, and the Webb Act, passed in 1918, supplemented the Sherman Act. In none of these was a definition of restraint of trade or monopoly given. These acts relate to administration and make restraint of trade a criminal offense. To find what the terms mean we must go to the common law. Mr. Justice White in *Standard Oil Co. v. United States*, speaking in regard to the terms "restraint of trade" and "monopoly," as used in the Sherman Act, said: "It is certain that those terms, at least in their rudimentary meaning, took their origin in the common law and were familiar in the law of this country prior to and at the time of the adoption of the act in question."

To determine what unlawful restraint of trade is, let us examine the common law. We find that in the very earliest times any restraint of trade, however slight, was unlawful. These were usually such restraints as result from the contract made between the vendor and vendee, as for example, when in selling his blacksmith shop, the vendor promises not to engage in that business.

Very early it appeared that to allow no power whatever to restrain was too harsh. All contracts involve restriction on the promisor and in some aspects can be viewed as restraint of trade. The courts, therefore, have evolved the rule that reasonable restraint of trade is allowable. This was set out in definite form for the first time in 1711 in *Mitchel v. Reynolds*.

The test of reasonableness has been applied to many diverse situations. Where the restriction is ancillary to the sale of a business or a term of employment, it is generally conceded to be valid if reasonable. It follows, that if the vendor of the blacksmith shop contracted with the buyer not to open a shop in that town for five years, it was generally considered reasonable because the restriction was only such as was necessary to protect the good-will which was sold. If the contract not to compete was so broad as not to be merely ancillary to the sale of the business then it was unreasonable. There was an

13 221 U. S. 1, 51 (1910).
14 1 P. Wms. 181.
injury to the covenantor and to the public because it interfered with the covenantor's right to earn a livelihood and deprived the public of his services, without a corresponding benefit to the covenantee. This rule of reasonableness is not limited to contracts ancillary to a sale of a business or a term of employment, but extends to other cases of restraint of trade where the restriction is imposed to protect an appropriate and legitimate interest of the covenantee.18

Price fixing agreements are a type of restraint of trade of comparatively recent origin. Mr. Justice Phillmore, speaking in a recent English decision,16 said, "Price maintenance agreements are modern things and are strange to those who have been brought up on the older lines, but they are in almost universal commercial use and it would be a scandal if they could not be enforced."

The English courts have applied the rule of reasonableness to price fixing agreements and have found them valid.17 Mr. Hughes in his opinion in the Miles case stated the rule as follows: "To sustain the restraint, it must be found to be reasonable both with respect to the public and to the parties and that it is limited to what is fairly necessary, in the circumstances of the particular case, for the protection of the covenantee."

Let us apply Mr. Hughes' rule to the price fixing contract. Suppose the manufacturer has spent large sums of money and years of time in perfecting his product and in advertising it. He has built up a good will which is a valuable asset in his business. It is only fair to the manufacturer to require the dealer to respect this property right and not to sell at a price which injures the manufacturer in his business. Such a contract does not interfere with the covenantee's right to earn a livelihood as does the agreement in the blacksmith case. It is evident that as between the parties there is no injury.

If the price fixing contract is to be declared unreasonable, it must be because it injures the public. Whether the

18 Elliman v. Carrington, [1901] 2 Ch. 275.
public is benefited or injured by price maintenance is an economic question and merits our consideration from that standpoint. One of the best articles to be found presenting the case against price maintenance is that of W. H. S. Stevens.\(^{18}\) He argues that price fixing agreements are unfair, first to the efficient jobber, second to the non-price maintaining manufacturer, and third to consumers and public generally. As to the first point, Mr. Stevens seems to think that it is unfair to the jobber who can handle his business more efficiently than his competitors to deprive him of the right to cut prices and gain a further advantage over those competitors. The weakness of this argument, as pointed out by Professor E. W. Puttkammer,\(^{19}\) is the assumption that the efficient jobber will be the one to cut prices. It is more likely that the price-cutter will not be the efficient jobber, but the one who has not a successful business, and hopes to attract customers who will buy other goods, on which he makes a profit sufficient to cover the loss on the cut price article.

Mr. Stevens’ second point is that price fixing is unfair to the manufacturer who does not care to maintain the resale price on his article. He says that if the price maintained article is preferred by dealers the manufacturer who does not maintain prices is injured. But such a manufacturer has the right to advertise and create a demand for his article as an identified one with respect to quality and reduced price and it is unlikely that the price maintained article if inferior in quality and higher in price can long maintain its prestige and superior drawing powers. All manufacturers would be competing under the same conditions and that should be sufficient to protect the producer of non-price maintained goods as well as consumers generally.

We next come to Mr. Stevens’ last point, namely: That price fixing agreements are unfair to the public generally. The alleged injury is that an increased price to the consumer is caused by the maintenance of the resale prices, and that competition is lessened. But is competition lessened? The manufacturers are still competing

\(^{18}\) 19 Col. L. Rev. 265.
\(^{19}\) 21 Ill. L. Rev. 389.
with each other. In fact, the result is to concentrate the competition there and make it sharper. Any loss of competition in price is made up by an increased competition in quality and service. This increased emphasis on quality and service is a much needed element in our modern merchandising. Price cutting has encouraged adulteration in almost every line of goods.

Let me illustrate the influence of price maintenance on competition. An eastern manufacturer employed a very large force. Most of these employees were getting their luncheon at nearby eating houses. An intense rivalry grew up between these eating houses, and as a result they were cutting prices on luncheons to sixteen and seventeen cents. They were making their bid on the price and cutting on the amount, which was causing malnutrition among the employees. The manufacturer then went to all the eating houses, and asked them to serve a standard twenty cent luncheon. The competition immediately swung to the quality and service. The employees were able to get an adequate luncheon at a given price and the arrangement was found to be much more satisfactory than before.

The public gains a distinct social advantage from price fixing agreements. The price fixing agreement forces the competition back to the producer and lessens it among distributors. This no doubt does protect the small distributor and corner grocery man. But is he not of value to society as well as the chain store and large mail order house? The small business is just as essential to society as the large business and should be protected. Greater distribution of wealth stabilizes the community.

There is a further advantage in the beneficial effect on business as a whole. The producer who could plan his business without danger of having his efforts brought to naught by price cutters would be more willing to invest his money. The inventor and small manufacturer would have a chance to get started.

A legally effective price fixing agreement is not only a benefit but a necessity as well. There has grown up of late a form of competition which is exceedingly pernicious. This is what is known as predatory price cutting.
Let me give an example. Suppose a manufacturer has specialized on the production of a dollar alarm clock. He has spent years of time and effort in building up his product and in selling it to the public. By sustained quality and constant advertising a demand has been created for this dollar alarm clock. His efforts are rewarded by the approbation of the consuming public. But a merchant down town is not thriving, and looks around for some way to increase his business. He advertises in the paper that he will sell this particular alarm clock for eighty-nine cents. The public, knowing very well the quality of the clock, are led to believe that this merchant is selling all his merchandise at a cut rate. The merchant makes his money back out of other articles on which he has not cut the prices. The public has gained nothing in the long run.

Other merchants, in order to meet the competition, also cut the price. The price war which ensues has two effects: first, it causes the merchant to push other goods on which he can make a profit, and second, to demand a cheaper price from the manufacturer. What is the manufacturer to do? He cannot cut his price without cheapening his article. He tries, therefore, to protect himself by price fixing agreements with his dealers, but these are declared illegal by the federal courts. The good will which he has so laboriously built up has come to naught because of that business parasite, the price cutter.

It follows that price fixing agreements are needed to cope with the unscrupulous dealer who tears down the prestige and drawing power of some manufacturer's product merely for the purpose of furthering his own ends. Contracts to protect a legitimate interest of this sort should be allowed.

In conclusion, we find that the invalidity of price fixing agreements depends on the rule of reasonableness which is applied to all restraints of trade. We find that these agreements do not create a combination which lessens competition but only shifts the competition from distributor to producer and from price to quality and service. Price fixing agreements injure neither the parties to the contract nor the public. In fact, we find distinct advan-
tages in such a system. In view of these facts are we justified in interfering with the freedom of contract?

A glance at the jurisdictions favoring price maintenance will disclose that the federal courts stand almost alone on this doctrine. England, France, Germany, and Denmark have taken a decided stand in favor of price maintenance.\(^2\) A majority of the states favor price maintenance.\(^2\) The important decisions handed down by the Supreme Court have been by a divided bench. Mr. Holmes, Mr. Brandeis, Mr. McReynolds, and Mr. McKenna have all favored price maintenance.\(^2\) Why should we interfere with contracts which bring sound economical results? The country has gone mad on regulation. Our zeal for regulation is only exceeded by our propensity for breaking the law. What the country needs is less regulation in business and more business in regulation.

\(^{20}\) Report of the committee on the maintenance of resale prices at the fourth annual meeting of the United States chamber of commerce (1916).

\(^{21}\) Fisher Flouring Mills Co. v. Swanson, 76 Wash. 649 (1913); Park v. National Druggist Association, 175 N. Y. 1 (1903).

\(^{22}\) Beechnut case, supra, note 10.