PROPERTY RIGHTS AND INTRABRAND RESTRAINTS

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Manufacturers must decide how to distribute their products to consumers. Some firms perform this function themselves, owning their own retail outlets and employing the salespeople who work there. Others choose to rely upon "the market," selling their products to independent firms who in turn sell the items to consumers.

Companies that choose the latter option often attempt to exercise some control over those who distribute their products, employing what economists and antitrust scholars call "intrabrand restraints." These contracts limit the discretion of one or more sellers — usually dealers — with respect to the disposition of a product sold under a single brand.[1] Such restraints may be "vertical," as when a single manufacturer grants its dealers exclusive territories or sets minimum resale prices.[2] They may also be "horizontal," as when a joint venture between competitors imposes exclusive territories or resale prices on members that distribute its product.[3] Such "partial integration" allows

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[1]*See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY, 441 (1999) (explaining distinction between intrabrand and interbrand restraints).

[2]*See, e.g.*, Monsanto Co. v. Spray-Rite Services, 465 U.S. 752 (1984) (evaluating alleged minimum resale price maintenance); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (evaluating exclusive territories and other vertical restraints).

[3]*See, e.g.*, United States v. TOPCO Assoc., Inc., 405 U.S. 596 (1972) (evaluating joint venture's imposition of exclusive territories on members that distributed its product). *See also*

a manufacturer or joint venture to assert control over firms that sell its product without owning them outright.

For many decades, economists, antitrust scholars and courts were hostile to intrabrand restraints. According to neoclassical price theory, the dominant approach to industrial organization during the 20th century, economic activity is conducted in one of two ways: the firm or the market. Within this intellectual framework, practices that are "between" the firm and the market are inherently suspect and seen as attempts by private parties to distort the natural competitive market to their advantage. Price theory's hostility to such "non-standard" agreements produced the "inhospitality tradition" in antitrust, whereby courts declared partial integration unlawful *per se* or presumptively unlawful. Intrabrand restraints — which controlled the disposition of products after their sale "on the market" — were for these courts a prime example of such anticompetitive practices.[4]

In recent decades, antitrust law and scholarship have experienced a revolution of sorts, as economists and other scholars have sought new explanations for non-standard agreements, including intrabrand restraints. Today, most economists and antitrust scholars believe that intrabrand restraints usually produce significant economic benefits by facilitating the distribution of products to

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Chicago Professional Sports Ltd. Partnership v. N.B.A., 95 F.3d 593 (7th Cir. 1996) (examining agreement among venture members limiting output of venture product); Rothery Storage, Inc. v. Atlas Van Lines Co., 792 F.2d 210 (D.C. Cir. 1986) (evaluating joint venture's imposition of minimum prices on members).

[4]*TOPCO*, 405 U.S. at *passim* (declaring horizontal exclusive territories ancillary to legitimate joint venture unlawful *per se*); Albrecht v. Herald Co., 390 U.S. 145 (1968) (declaring vertical maximum resale price maintenance unlawful *per se*); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1968) (declaring location clauses and other vertical intrabrand restraints unlawful *per se*). *See also* nn. ____, *infra* and accompanying text (collecting other authorities).

consumers.[5] This agreement is not universal, however: some scholars still "hold out" against the claim that intrabrand restraints are presumptively efficient.[6] Echoing the inhospitality tradition, these scholars continue to emphasize the purported harms that such restraints can cause, while at the same time doubting their supposed benefits.[7]

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[5]*See, e.g.*, RICHARD A. POSNER, ANTITRUST LAW, 171-89 (2001); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 485 ("Most price and nonprice [vertical] restraints are efficient and benefit consumers."); OLIVER E. WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM, 185-89 (1985); *id*. at 28 (articulating a "rebuttable presumption that nonstandard forms of contracting have efficiency purposes."); Victor P. Goldberg, *The Free Rider Problem, Imperfect Pricing, And The Economics Of Retailing Services*, 79 NW. U. L. REV. 736, 738 (1984) (suggesting there is an "embarrassment of riches" when it comes to beneficial explanations of vertical restraints); ROBERT H. BORK, THE ANTITRUST PARADOX, 290-91, 449-50 (1978) (asserting that vertical distribution restraints should be lawful *per se*).

While most scholarly discussion has focused on *vertical* intrabrand restraints, similar reasoning has led many of the same scholars to a presumption in favor of intrabrand restraints that are horizontal. *See, e.g.*, POSNER, ANTITRUST LAW, at 187-89; BORK, ANTITRUST PARADOX, at 274-79 (horizontal intrabrand restraints should be presumed lawful).

[6]*See*, *e.g.*, Peter C. Carstensen, *The Competitive Dynamics of Distribution Restraints: The Efficiency Hypothesis Versus The Rent-Seeking, Strategic Alternatives*, 69 ANTITRUST L. J. 569 (2001); RUDOLPH PERITZ, COMPETITION POLICY IN AMERICA, 1888-1992, 257-58 (2001) (contending that vertical intrabrand restraints generally harm consumers because they result in "monopolistic competition — the product differentiation, the market fragmentation through advertising and promotion, and the pursuit of brand loyalty leading to higher costs and higher prices"); LAWRENCE SULLIVAN AND WARREN GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK, 297-316 (2000) (identifying numerous purported harms produced by vertical intrabrand restraints and downplaying their benefits); *id*. at 327-35 (2000) (suggesting "structured rule of reason" whereby proof of product differentiation suffices to establish presumption that such restraints are unlawful); *id.* at 664-67 (courts should presume horizontal intrabrand restraints unlawful); John J. Flynn, *The "Is" and "Ought" of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Co.*, 71 CORNELL L. REV. 1095 (1986); Robert Pitofsky, *A Framework for Antitrust Analysis of Joint Ventures*, 74 GEO. L.J. 1605, 1620-21 (1986) (treating horizontal intrabrand restraints as presumptively unlawful). *See also* Robert Pitofsky, *Why Dr. Miles Was Right*, 8 Regulation 27 (1984) (arguing that minimum resale price maintenance should be unlawful *per se*).

[7]*See*, *e.g.*, Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at *passim*; Robert Pitofsky, *In Defense of Discounters: The No Frills Case For A Per Se Rule Against Vertical Price Fixing*, 71 GEO. L. J. 1487 (1983). *See also* nn. ____, *infra* and accompanying text.

Notwithstanding these holdouts, the trend among academics seems unmistakable: most advocate a strong presumption that intrabrand restraints are procompetitive.[8] Over the past three decades, the work of these scholars has influenced judges, and courts have adjusted antitrust doctrine in several ways that reflect this academic consensus.[9] This adjustment is not nearly complete — courts are still hostile to various intrabrand restraints — particularly those that explicitly invoke price or output.[10]

Despite these developments in theory and doctrine, there is continued disagreement among proponents of intrabrand restraints about the exact mechanism through which such restraints supposedly reduce the cost of distribution. The dominant approach, first articulated by Lester Telser, focused on vertical intrabrand restraints, but had implications for horizontal arrangements as well.

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[8]*See* nn. ____, *supra* and accompanying text (collecting scholarly authorities). One holdout has recently claimed that the presumption in favor of intrabrand restraints is "generally associated with the Chicago School" of antitrust analysis. *See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 571. It is certainly true that members of the Chicago School pioneered the theoretical claim that such restraints are generally efficient. However, several leading scholars outside the Chicago School explicitly embrace the presumption that vertical restraints are usually procompetitive. *See*, *e.g.*, HOVENKAMP, FEDERAL ANTITRUST POLICY, at 450-58, 485-89; WILLIAMSON, ECONOMIC INSTITUTIONS, at 185-89.

[9]*See*, *e.g.*, State Oil v. Khan, 522 U.S. 3, 16-19 (1997) (invoking academic commentary to reject *per se* rule against maximum resale price maintenance); Business Electronics Corp. v. Sharp Electronics, 485 U.S. 717, 725-31 & nn. 3-4 (1988) (relying in part upon academic commentary to cabin scope of *per se* rule against minimum resale price maintenance); Continental T.V. v. G.T.E. Sylvania, 433 U.S. 36, 55-57 (1978) (relying upon academic commentary to reject *per se* rule against location clauses and other vertical territorial restraints).

[10]*See* N.C.A.A. v. Bd. of Regents, University of Oklahoma, 468 U.S. 85 (1984) (horizontal intrabrand restraints that increase price or reduce output are presumptively unlawful); Monsanto v. Spray-Rite Services Corp, 465 U.S. 752 (1984) (declining invitation by the Solicitor General of the United States to reconsider *per se* rule against minimum resale price maintenance). *See also* California Dental Ass'n. v. F.T.C., 526 U.S. 756, 769-70 (1999) (explicit horizontal restraint on price or output establishes *prima facie* case that restraint is unlawful); *Business Electronics Corp.*, 485 U.S. at 725-26 (adhering to *per se* rule against minimum rpm) (*dicta*).

According to Telser, such restraints can overcome a form of market failure that might result when manufacturers rely upon independent dealers — the market — to distribute their goods.[11] Left to their own devices, it is said, individual dealers will refuse to produce certain promotional services — information — that enhance consumer demand for the manufacturer's product, choosing instead to free ride on the promotional efforts of fellow dealers.[12] Since all dealers will find it rational to free ride in this manner, no dealer will provide such promotional services, and demand for the manufacturer's product will fall accordingly. According to Telser and others, vertical intrabrand restraints can prevent such free riding by eliminating price competition between dealers and thus channeling dealers' competitive efforts into other forms of rivalry, in particular, the provision of pre-sale promotion desired by the manufacturer.[13] Other scholars have extended Telser's analysis to explain various intrabrand restraints that are horizontal in nature.[14]

Some scholars who are sympathetic to intrabrand restraints have nonetheless rejected Professor Telser's account. In particular, two scholars — Benjamin Klein and Kevin Murphy — have argued that such restraints cannot overcome the market failure that Telser identified.[15] While

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[11]*See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade*?, 3 J. L. & ECON. 86 (1960).

[12]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91-92.

[13]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91-93. *See also*, *e.g.*, POSNER, ANTITRUST LAW, at 172-75; BORK, ANTITRUST PARADOX, at 290-91, 449-50.

[14]*See* nn. ____, *infra* and accompanying text.

[15]*See* Benjamin Klein and Kevin M. Murphy, *Vertical Restraints As Contract Enforcement Mechanisms*, 31 J. L. & ECON. 265 (1988). *See also* Benjamin Klein, *Distribution Restrictions Operate By Creating Dealer Profits: Explaining The Use Of Maximum Resale Price Maintenance In State Oil v. Khan*, 7 S. CT. ECON. REV. 1 (1999).

these scholars agree that dealers are prone to free ride on each others' promotional efforts, they reject the claim by Telser and others that intrabrand restraints can themselves prevent such conduct.[16] In particular, these scholars correctly note that Professor Telser has not explained how such restraints, in fact, induce dealers to engage in the precise promotional activities desired by the manufacturer. Instead, these scholars argue, vertical intrabrand restraints are private mechanisms for enforcing implicit contractual obligations that dealers assume as a condition of distributing the manufacturer's product. More precisely, by conferring market power on dealers, it is said, intrabrand restraints create a stream of income that dealers will forfeit if terminated and thus serve as a sort of "performance bond" that dealers "post" by agreeing to such restraints.[17] Such bonds do not themselves cause dealers to engage in any promotional activity. They do, however, facilitate a manufacturer's efforts to ensure dealers' compliance with obligations to engage in promotional efforts, as well as other obligations unrelated to promotion.[18]

While these two benign accounts of intrabrand restraints are in obvious tension with one another, both also share some common characteristics. For one thing, both take as a given the manufacturer's decision not to integrate forward into distribution, that is, to rely upon "the market" to distribute its goods. Such an approach is consistent with neoclassical price theory, which took the boundaries of a firm as a given, determined by technology. Both also assume that reliance on the market can come with a cost in the form of dealer free riding. Moreover, while both accounts focus

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[16]*See* Klein and Murphy, *Vertical Restraints,* 31 J. L. & ECON. at 266-67. *See also* nn. ____, *infra* and accompanying text.

[17]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 274-76; *id*. at 284-85.

[18]*See id*.

on vertical intrabrand restraints, both can readily apply to certain intrabrand restraints that are horizontal, explaining, for instance, why a joint venture might assign members selling its product exclusive territories.[19] Finally, and most importantly, both rest upon the price-theoretic assumption that manufacturers "know" what types of services they wish dealers to provide and that manufacturers employ intrabrand restraints in an effort to induce dealers to provide that desired mix and level of services. Put another way, both approaches seem to conclude that such restraints are mechanisms that manufacturers employ to "plan" the promotional activities of their dealers, much as a firm "plans" the activities of its employees. This planning assumption, it will be seen, renders each approach vulnerable to certain criticisms leveled by opponents of such restraints.

This article offers an alternative framework for evaluating and explaining intrabrand restraints, a framework derived from the concept of property. Unlike neoclassical price theory, a property rights approach can explain why firms rely upon the market to distribute their goods and also help illuminate the rationale for intrabrand restraints. In particular, this article argues that many vertical intrabrand restraints can be characterized as contracts for property rights, rights that facilitate and perfect a manufacturer's decision to rely upon the market to distribute its goods. More precisely, such agreements can often be characterized as means of vesting dealers with exclusive rights over a valuable resource, namely, customers who decide to purchase a manufacturer's product. By perfecting dealer property rights, manufacturers can transform information from a collective good to a private good, thus facilitating its production.[20] In the same way, a joint venture among

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[19]*See* nn. ____, *infra* and accompanying text. *See also TOPCO*, 405 U.S. at *passim* (declaring such territories unlawful *per se*).

[20]*See generally* Ronald H. Coase, *The Lighthouse In Economics*, 17 J. L. & ECON. 357 (1974) (explaining that a good's status as public or collective on the one hand, or private on the other, can

competitors can use horizontal intrabrand restraints to perfect the property rights of members who distribute the venture's product.

Importantly, the existence and enforcement of such restraints does not depend upon any implicit or explicit assumption that manufacturers possess the knowledge necessary to plan or anticipate the promotional activities of their dealers. Such a planning-based account imputes an extraordinary amount of prescience to the manufacturer. In the real world, knowledge of optimal promotional strategies is difficult to obtain; no single firm can readily gather and possess all such information. Because they assume the ready availability of knowledge about optimal promotional strategies, both planning accounts ignore one rationale for relying upon a dealer-based system of distribution in the first place, namely, the desire to decentralize authority over promotional decisionmaking. By relying upon the market and vesting dealers with property rights, it is argued, manufacturers empower *dealers* to determine what sorts of promotional efforts make sense, *i.e.*, what sorts of information to produce. At the same time, these restraints ensure that dealers who produce such information can recover the cost of doing so, thus perfecting dealers' market-based incentives to identify and execute optimal promotional strategies. Thus, a planning account errs by assuming that manufacturers possess the very knowledge that reliance on the market and intrabrand restraints help create.

To be sure, a manufacturer could maintain a form of property rights in information by integrating forward into the distribution of its product, relying upon salaried employees with access to knowledge about local conditions to make its promotional decisions. In this way the manufacturer would ensure that only a single entity, the manufacturer itself, would internalize the benefits of

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depend upon the assignment of property rights).

producing information useful to consumers. At the same time, however, such reliance on employees with little or no stake in promotional outcomes would deprive the manufacturer of a key aspect of a market-based system of distribution, namely, independent dealers who internalize the profit that results from their promotional efforts. By contrast, intrabrand restraints can allow manufacturers to have the best of both worlds: dealers who possess localized knowledge *and* appropriate incentives to promote the manufacturer's product. In this way, a manufacturer can avoid the shortcomings of complete vertical integration while at the same time realizing the full benefits of a market-based system of distribution. Other benign accounts have simply ignored the role that such restraints can play in facilitating a strategy of decentralized, market-based distribution.

By rejecting the planning assumption inherent in current benign accounts, a property rights theory offers a more plausible explanation of how such restraints ensure that dealers engage in appropriate promotional activities. As a result, the property approach helps amend and thus bolster Professor Telser's standard account against both friendly and not-so-friendly critiques. For one thing, a property-based account responds to claims that intrabrand restraints cannot themselves induce the exact sort of promotion desired by the manufacturer. These claims, it is shown, simply miss the point of such restraints, which is to facilitate a strategy of decentralized generation of knowledge about local promotional strategies. Such an approach rests on a manufacturer's *rejection* of any desire to obtain a particular mix of promotional services. Moreover, a property account provides a more robust response to the perennial assertion that less restrictive alternatives — including complete vertical integration — will advance the legitimate objectives of intrabrand restraints without producing off-setting harms. Furthermore, a property rights account applies with equal force to intrabrand restraints that are horizontal, explaining, as it does, a joint venture's

imposition of intrabrand restraints on members that distribute its product. In short, a property rights conception of intrabrand restraints places the current scholarly attitude toward these agreements on a more certain footing and further bolsters the case for presuming that such restraints are procompetitive. Finally, a property rights approach suggests that courts should continue to adjust antitrust doctrine governing intrabrand restraints, subjecting all such restraints to lenient Rule of Reason treatment.

The property rights account of intrabrand restraints offered here does not purport to explain all such contracts. Not all products require the sort of pre-sale promotional services identified by Professor Telser and others who have extended his analysis. Thus, intrabrand restraints employed in some industries require a different explanation. Nonetheless, where products do require pre-sale promotion incident to their sale, a property rights account provides the most plausible description of the rationale for such restraints.

Part I of this article canvasses the competing benign accounts of intrabrand restraints, as well as the critiques of these accounts. Both benign accounts, it is shown, rest upon an assumption that manufacturers possess the knowledge necessary to "plan" or anticipate the precise promotional activities of those who distribute their products, and this assumption gives rise to various critiques by scholars hostile to such restraints. Part II offers a competing, "property rights" conception of such restraints, a theory that rejects the planning assumption inherent in these two accounts. Part III explains how the property rights approach amends and bolsters Professor Telser's analysis against various critiques and suggests some doctrinal implications of this account.

I. COMPETING ACCOUNTS OF INTRABRAND RESTRAINTS

A. Two Benign Accounts Of Intrabrand Restraints

For decades economists and legal scholars viewed intrabrand restraints with suspicion. The dominant economic paradigm of the day — neoclassical price theory — rested on several assumptions that, taken together, produced an intellectual milieu quite hostile to such restraints. The firm of price theory was a "black box," a production function with a unitary interest that took in inputs and transformed them into outputs.[21] Moreover, the boundary between the "firm" and "the market," that is, the distinction between what a firm produces itself and what it leaves to others, was a given, determined by technological considerations common to all firms in a given industry.[22] In

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[21]*See* Richard N. Langlois, *Contract, Competition, And Efficiency*, 55 BROOKLYN L. REV. 831, 834 (1989) ("the economists' firm — at least until recently — was a black box, a production function that took in inputs and transformed them into outputs."); *id.* at 835 (describing traditional theory's failure to recognize benefits of non-standard contracting); Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271, 272 (1987) (describing the "prevailing practice [under price theory] of describing the firm as a production function whose natural boundaries were defined by technology. Economic inputs were thus transformed by the production technology into economic outputs. Organizational considerations [that might explain the boundaries of firms] were effectively suppressed."); WILLIAMSON, ECONOMIC INSTITUTIONS, at 371 (describing price-theoretic view that "true economies take a technological form, [and] hence are fully realized within firms. [Thus], according to the price-theoretic paradigm, there was nothing to be gained by introducing nonstandard terms into market-mediated exchange."); Ronald H. Coase, *The Firm, The Market, and The Law*, in RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW, 3 (1988) ("The firm to an economist . . . 'is effectively defined as a cost curve and a demand curve, and the theory [of the firm] is simply the logic of optimal pricing and input combination.'"), *quoting* Marten Slater, Forward to EDITH T. PENROSE, THE THEORY OF THE GROWTH OF THE FIRM, ix (2d ed. 1980).

[22]*See* Richard N. Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, in COASEAN ECONOMICS: LAW AND ECONOMICS AND THE NEW INSTITUTIONAL ECONOMICS 1, 2-4 (Steven G. Medema ed., 1998) (describing technological focus of so-called "Pigouvian price theory"); Oliver E. Williamson, *Technology and Transaction Cost Economics*, 10 J. ECON. BEH. & ORG. 355, 356 (1988) (asserting that under, price-theoretic paradigm, "the 'natural' boundaries of the firm were thought to be defined by engineering considerations."); WILLIAMSON, ECONOMIC INSTITUTIONS, at 7-8 ("The prevailing orientation toward economic organization [under price theory] was that technological features of firm and market organization were determinative."); *id.* at 23-26, 86-89; George Stigler, *The Division of Labor is Limited By the Extent of the Market*, 59 J. POL. ECON. 185, 185 (1951) (stating that economic theory has "generally treated as a (technological?) datum the problem of what the firm does — what governs its range of activities or functions."); F. A. Hayek, *The Meaning of Competition*, in F.A. HAYEK, FREE ENTERPRISE AND ECONOMIC ORDER,

this price-theoretic world, it cost little or nothing to acquire or transfer information, and firms and consumers rarely behaved in an opportunistic manner.[23] Given these assumptions, there was no rationale for a manufacturer to control the disposition of its product after title passed to another firm or consumer.[24] Price theory, in turn, gave rise to the so-called "inhospitality tradition" of antitrust, which presumed that all "non-standard" contracts, including intrabrand restraints, were efforts to

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92, 97-98 (1948) (explaining link between assumption that all firms possessed the same production technology, and assumption that information was costless to obtain).

[23]Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, at 2 ("In this kingdom [the price-theoretic paradigm], knowledge remains explicitly and freely transmittable, and cognitive limits seldom if ever constrain."). *See also* Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 ILL. L. REV. ____, ____ (forthcoming) (examining price theory's tendency to assume away opportunism).

[24]*See* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ____.

create or exercise market power.[25] Antitrust law generally tracked these insights, declaring most such restraints unlawful *per se*.[26]

Just over four decades ago, Lester Telser offered a radically different account of intrabrand restraints, an account that implicitly rejected certain price-theoretic assumptions that drove the

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[25]*See* Meese, *Price Theory and the Rule of Reason*, 2003 Il. L. Rev. at ____. *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 19 (describing inhospitality tradition of antitrust); *id.* at 370-73 (describing influence of inhospitality tradition on antitrust treatment of non-standard contracts); Frank H. Easterbrook, *Is There A Ratchet In Antitrust Law?*, 60 TEX. L. REV. 705, 715 (1982) ("[the] inhospitality tradition of antitrust . . . called for courts to strike down business practices that were not clearly procompetitive. In this tradition an inference of monopolization followed from the courts' inability to grasp how a practice might be consistent with substantial competition. The tradition took hold when many practices were genuine mysteries to economists, and monopolistic explanations were congenial. The same tradition emphasized competition in the spot market. Long-term contracts, even those arrived at by competitive processes, were deemed anticompetitive because they shut off day-to-day rivalry."). The phrase "inhospitality tradition" apparently was coined by Professor Donald Turner, an economist at Harvard Law School, who headed the Antitrust Division of the Department of Justice in the 1960s. According to Professor Turner: "I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law." Donald F. Turner, *Some Reflections on Antitrust*, 1966 N.Y. ST. B.A. ANTITRUST L. SYMP. 1, 1-2. *See also* Michael S. Jacobs, *The Normative Foundations of Antitrust Economics*, 74 N. C. L. REV. 219, 227-28 (1995) (describing so-called Harvard School of industrial organization and antitrust policy during this period); nn. ____, *infra* and accompanying text (collecting decisions contending that (price-theoretic) "competition" would maximize social welfare).

[26]*See, e.g.,* United States v. TOPCO Assoc., Inc., 405 U.S. 596 (1972) (finding horizontal exclusive territory ancillary to single-brand joint venture unlawful *per se*); Albrecht v. Herald Co., 390 U.S. 145 (1968) (declaring maximum resale price maintenance unlawful *per se*); United States v. Sealy, Inc., 388 U.S. 350 (1968) (declaring horizontal price fixing ancillary to legitimate joint venture unlawful *per se*); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1968) (finding location clause and other vertical restraints unlawful *per se*); Simpson v. Union Oil Co., 377 U.S. 13 (1964) (finding consignment agreement setting price of manufacturer's product unlawful *per se*). The Court and scholars showed equal hostility to interbrand restraints. *See* FTC v. Brown Shoe Co., 384 U.S. 316 (1966); Standard Oil Co. v. United States, 337 U.S. 293 (1949). *See also* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ___ (describing academic and judicial opposition to intrabrand and interbrand restraints).

inhospitality tradition.[27] Like price theorists, Telser began with the unexplained assumption that a manufacturer has chosen to rely upon the market to distribute its products.[28] At the same time, Telser argued that effective distribution may in some instances require dealers to provide consumers with what he called "special services," particularly information about the product's attributes, prior to sale.[29] Unlike the underlying product, however, such information is a collective good; the dealer who produces such information cannot exclude non-paying consumers from it.[30]

Contrary to the assumptions of price theory, information is not free.[31] Moreover, like the production of most collective goods, the production of "special services" is potentially beset by a form of opportunism, namely, "free riding."[32] A dealer that produces such information cannot charge consumers who use it a price; at best the dealer can hope that the consumer will purchase the

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[27]*See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade*?, 3 J. L. & ECON. 86 (1960).

[28]*See* nn. ____, *supra* and accompanying text (explaining that price theory took the boundaries of the firm as a given, determined by technology).

[29]*See* Telser, *Fair Trade*, at 89-90.

[30]*Id*. at 89-91. *See also* MANCUR OLSEN, THE LOGIC OF COLLECTIVE ACTION, 13-15 (1965) (defining collective good). To be sure, there are some instances in which dealers could, conceivably, recoup the cost of pre-sale promotion directly from customers. For instance, a dealer could charge consumers for product demonstrations. Few consumers would be willing to pay for such demonstrations, however, because they would not know the value of the demonstration until *after* they received it. *See* n. ____, *infra* (explaining that a purchaser does not understand the value of information until he or she actually receives it).

[31]*See* nn. ____, *supra* and accompanying text (outlining price theory's assumption that production and dissemination of information is costless).

[32]*See generally* OLSEN, LOGIC OF COLLECTIVE ACTION, at 9-12, 26-31. *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 47 (defining opportunism as pursuit of self-interest at the expense of trading partners "with guile").

underlying good from it, at a price that reflects the cost of the information.[33] If, however, consumers are rational, they will do what they can to avoid paying for this information, even if they should ultimately choose to purchase the product in question. At the same time, rational dealers will behave in an opportunistic manner, seeking to attract these consumers by forgoing the production of information and offering them the product in question at a price lower than that charged by dealers who do produce such information.[34] If dealers and consumers act rationally, it is said, no dealer will produce such special services, and demand for the manufacturer's product will fall.[35]

Given the tendency of dealers to free ride, then, reliance on the sort of unrestricted market imagined by price theory to distribute goods will result in a market failure and suboptimal demand for the manufacturer's product. Minimum resale price maintenance ("minimum rpm"), it is said, can cure this failure, by undermining dealer and customer efforts to free ride. So, for instance, a contract setting a floor below which a dealer cannot price (minimum rpm) can prevent free riding dealers

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[33]KENNETH ARROW, ESSAYS IN THE THEORY OF RISK BEARING, 152 (1971) ("[information's] value for the purchaser is not known until he has the information, but then he has in effect acquired it without cost."). *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 9.

[34]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91 ("some retailers have good reason not to provide these special services and offer to sell the product at lower prices. They reduce their prices because they avoid the additional cost of the special services."). *Compare* nn. ____, *supra* and accompanying text (explaining how price theory assumed away opportunism by dealers and others).

[35]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91 ("As a result [of distributor free riding] few or none of the retailers offer the special services the manufacturer thinks necessary to sell his product."). *See also* Lester G. Telser, *Why Should Manufacturers Want Fair Trade II*, 33 J. L. & ECON. 409, 409-410 (1990) (absent some vertical control, free riding among retailers will lead to an inefficient equilibrium in which no retailer provides special services); OLSEN, LOGIC OF COLLECTIVE ACTION, at 27 ("Normally the provision of the collective good will be strikingly suboptimal."); *id.* at 28 ("There is a tendency for large groups to fail to provide themselves with any collective good at all.").

from undercutting a full service retailer.[36] Indeed, Professor Telser argued that such an agreement will do more than prevent free riding; it will also cause dealers to engage in various forms of non-price competition. Just as a cartel agreement will lead participants to "cheat" by, for instance, offering ancillary services "under the table," so too will minimum rpm induce dealers to "cheat" by engaging in non-price competition.[37] Promotional expenditures, of course, are one form of such competition; by setting a floor on the price dealers can charge, Telser said, a manufacturer can ensure that any retailer rivalry takes the form of promotional services desired by the manufacturer.[38]

While Professor Telser's analysis focused on the possibility that minimum rpm — a vertical restraint — can induce pre-sale promotion, other scholars extended his analysis. Some expanded the definition of promotional services that minimum rpm can generate.[39] So, for instance, some scholars argued that a manufacturer can employ minimum rpm to compensate fashionable retailers for carrying the manufacturer's product, thus certifying to consumers that the item is of high

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[36]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 90-91.

[37]It should be noted that Professor Telser did not himself invoke the analogy to a cartel. Subsequent scholars did so. *See*, *e.g.*, RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE, 148-49 (1976).

[38]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 90-91.

[39]*See* Howard P. Marvel and Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984) (arguing that resale price maintenance compensates reputable dealers for choosing to stock a manufacturer's product, thus signalling the product's quality to consumers); Victor P. Goldberg, *The Free Rider Problem, Imperfect Pricing, and the Economics Of Retailing Services*, 79 NW. U. L. REV. 736 (1984). *See also* Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond The Conventional Wisdom*, 63 ANTITRUST L.J. 59 (1993).

quality.[40] Others applied his analysis to different vertical restraints.[41] These scholars argued that an exclusive territory, for instance, can eliminate or attenuate the prospect of dealer free riding and thus ensure that dealers who provide special services do not suffer at the expense of those who refuse to do so.[42] Similarly, many of these same scholars applied Telser's analysis to intrabrand restraints that are horizontal in nature. These scholars argued that horizontal divisions of territory or horizontal price fixing ancillary to legitimate joint ventures can assure appropriate promotion of the venture's product and should thus be presumed lawful.[43] Numerous antitrust scholars and economists have

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[40]*See* Marvel and McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. at *passim*; Goldberg, *Economics of Retailing Services*, 79 NW. U. L. REV. at 744-46 (arguing that manufacturers can employ minimum rpm to purchase a dealer's "endorsement" of its product).

[41]*See* Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L. J. 373, 430-438 (1966). *See also* Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 Colum. L. Rev. 282 (1975). Indeed, even before Bork and Posner extended Professor Telser's analysis, litigants were advancing similar arguments before courts and the enforcement agencies. *See*, *e.g.*, Brief of the White Motor Company at 42-43, in White Motor Co. v. United States, 372 U.S. 253 (1963) (arguing that reservation of customers and exclusive territories were necessary to ensure that "dealers who have spent valuable time 'pre-selling' a customer — *i.e.*, softening him up for a White sale instead of a G.M. or Ford sale — will not lose the legitimate reward of their labor to another White dealer who jumps territorial boundaries at a strategic moment and snatches away the pre-sold customer.").

[42]*See* Posner, *Antitrust Policy and the Supreme Court*, 75 COLUM. L. REV. at 283-85; Bork, *Price Fixing And Market Division*, 75 YALE L. J. at 430-38.

[43]*See* Alan J. Meese, *Farewell to the Quick Look: Reconstructing the Scope and Content of the Rule of Reason*, 68 ANTITRUST L. J. 461, 478-89 (2000) (applying Telser's analysis to explain horizontal exclusive territories ancillary to a legitimate joint venture); *id*. at 491-93; HOVENKAMP, FEDERAL ANTITRUST POLICY, at 205-208; Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886 (1981); BORK, ANTITRUST PARADOX, at 270-79; Posner, *Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. at 298-99 (antitrust treatment should not turn on characterization of restraints as "horizontal" or "vertical" but instead upon whether restraints produce benefits); *id*. (arguing that horizontal ancillary restraints should be lawful absent showing of market power). *See also* Rothery Storage & Van Co. v. Atlas Van Lines,

since invoked Telser's analysis in support of assertions that intrabrand restraints — whether vertical or horizontal — are generally procompetitive.[44] Moreover, the Supreme Court has relied upon this analysis to justify relaxation of the antitrust standards applied to certain intrabrand restraints, directing lower courts to analyze restraints that do not invoke price or output under a lenient "Rule of Reason."[45] On the other hand, the inhospitality tradition continues to exercise significant influence on antitrust doctrine. In particular, intrabrand restraints that do invoke price or output are either unlawful *per se* or presumptively unlawful pursuant to a truncated Rule of Reason test under which proof of a restraint's existence automatically gives rise to a *prima facie* case, thus requiring some justification by the defendants.[46]

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792 F.2d 210 (D.C. Cir. 1986) (Bork, J.) (finding horizontal price fixing ancillary to joint venture a reasonable restraint because it deterred free riding); Polk Bros., Inc. v. Forest City Enterprises, 776 F.2d 185 (7th Cir. 1985) (Easterbrook, J.) (holding that horizontal ancillary restraint might plausibly combat free riding and thus should be analyzed under the Rule of Reason). *Cf.* United States v. TOPCO Associates, Inc., 405 U.S. 596 (1972) (declaring division of territories ancillary to legitimate joint venture unlawful *per se*).

[44]*See* POSNER, ANTITRUST, at 147-66; BORK, ANTITRUST PARADOX, at 290-91; Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L. J. 135 (1984).

[45]*See Business Electronics Corp.*, 485 U.S. at 727-28 (relying upon such an analysis to narrow scope of *per se* rule against minimum rpm); *GTE Sylvania*, 433 U.S. at 55-57 (invoking such reasoning to overrule *per se* rule against exclusive territories). *See also* HOVENKAMP, ANTITRUST POLICY, at 480 (concluding that Rule of Reason applied to nonprice restraints "has come close to creating complete nonliability").

[46]*See Monsanto*, 465 U.S. at 761, n. 7 (reaffirming *per se* rule against minimum rpm); Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332 (1982) (declaring horizontal maximum price fixing ancillary to a legitimate joint venture unlawful *per se*). *See also* California Dental Ass'n. v. F.T.C., 526 U.S. 756, 769-70 (1999) (explicit horizontal restraint on price or output establishes *prima facie* case that restraint is unlawful under the Rule of Reason); *NCAA*, 468 U.S. at 100 (stating that horizontal restraints on price or output are generally unlawful *per se*, even when ancillary to a legitimate joint venture); *id.* at 101 (declining to apply *per se* rule where some horizontal cooperation was necessary to create product in the first place).

To be sure, Professor Telser's "special services" argument suggests that minimum rpm and other intrabrand restraints result in prices that are higher than an unrestrained market would produce.[47] However, such prices do not reflect an exercise of market power or other consumer harm. Instead, such prices simply indicate an economic truism, namely, that the production of special services (information) costs money, and firms that produce this information must recoup their costs of doing so to remain in business.[48] A cost-based price increase, whether by dealers or a fully-integrated firm, does not reflect an exercise of market power.[49]

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[47]There is, of course, one exception: intrabrand restraints that involve *maximum* price fixing. *See Maricopa Med. Soc'y*, 457 U.S. at *passim* (declaring horizontal maximum rpm unlawful *per se*); Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. at *passim* (explaining how such restraints can overcome various market failures).

[48]*See* Easterbrook, *Vertical Restraints and the Rule of Reason*, 53 ANTITRUST L. J. at 156 ("Every restricted dealing arrangement is designed to influence price. It must be. If territorial limits induce dealers to supply additional service and information, they do so only because they raise the price and call forth competition in the service dimension. . . . Every argument about restricted dealing implies that the restrictions influence price. There is no such thing as a free lunch; the manufacturer can't get the dealer to do more without increasing the dealer's margin."); Posner, *Analysis of the Restricted Distribution, Horizontal Merger, and Potential Competition Decisions*, 75 COLUM. L. REV. at 284; William F. Baxter, *Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 945-46 (1987):

> Higher retail prices are entirely consistent with the benign explanation of resale price maintenance. Imposition of [resale price maintenance] reflects a judgment on the part of the brand owner that her products will compete more successfully, both against other branded products and against generic rivals, if the retailer competes along parameters other than price. And the retailer's expenses of engaging in those other forms of rivalry are financed by setting a retail margin higher than would prevail if retail price competition were allowed or encouraged.

See also Telser, *Why Should Manufacturers Want Fair Trade*, 3 J. L. & ECON. at 91 (absent such restraints dealers "reduce their prices because they avoid the additional cost of the special services").

[49]*See* Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 ILL. L. REV. at ___ (explaining that cost-based price increase induced by restraint does not reflect exercise of market power); Alan J. Meese, *Tying Meets The New Institutional Economics*, 146 U. PENN. L. REV. 1, 70

Professor Telser's account of minimum rpm did not purport to explain all such restraints. Instead, Telser expressly limited this account to differentiated products that require pre-sale promotion to attract at least some consumers.[50] At the same time, he explained that, in some cases such restraints could facilitate cartelization among manufacturers, by preventing dealers from passing along discounts offered by manufacturers attempting to undercut the cartel price.[51] In the end, however, he ultimately concluded that such restraints were presumptive efforts at inducing dealers to produce optimal pre-sale promotional services.[52]

Despite its broad acceptance, Professor Telser's theory is not the only benign account of intrabrand restraints. Instead, two scholars — Benjamin Klein and Kevin Murphy — have offered what might best be deemed a "friendly amendment" to Telser's approach.[53] Like Telser, these scholars begin with the assumption that manufactures rely upon the market to distribute their goods.[54] Moreover, these scholars do not question the prevailing wisdom that intrabrand restraints

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(1997) (explaining that a cost-based price differential that induces acceptance of a tying contract does not reflect an exercise of market power and thus does not raise antitrust concerns).

[50]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 95-96.

[51]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 96-99.

[52]*See* Telser, *Fair Trade II*, 33 J. L. & ECON. at 410.

[53]*See* Benjamin Klein and Kevin M. Murphy, *Vertical Restraints As Contract Enforcement Mechanisms*, 31 J. L. & ECON. 265 (1988). *See also* Benjamin Klein, *Distribution Restrictions Operate By Creating Dealer Profits: Explaining The Use Of Maximum Resale Price Maintenance In State Oil v. Khan*, 7 S. CT. ECON. REV. 1 (1999).

[54]Klein and Murphy do mention that complete vertical integration is one method distribution. *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 285. At the same time, they apparently assume that such integration is indistinguishable from reliance on the market. They thus make no effort to explain *why* a manufacturer might choose to rely on the market to distribute its goods.

are generally procompetitive.[55] Nor do they question Telser's claim that opportunistic free riding will prevent dealers from providing special services.[56] Finally, while these scholars focus on vertical intrabrand restraints, their analysis has equal application to those that are horizontal in nature.[57]

Nonetheless, these scholars do take issue with Telser's claim that intrabrand restraints can themselves cure dealer free-riding. For one thing, such restraints are not airtight; instead, a dealer can circumvent a minimum rpm agreement, for instance, by offering secret rebates or generous warranties, and bundling discounted items with the main product.[58] Thus, while such restraints may induce non-price competition, there is no guarantee that they will induce the particular form of competition desired by the manufacturer.[59] Moreover, even if a manufacturer can police and enforce

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[55]*See generally* Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AMER. ECON. REV. 356 (1980).

[56]*See* Klein, *Distribution Restrictions*, 7 S. CT. ECON. REV. at 5-8 (providing an excellent summary of the so-called "classic free riding" account of dealer behavior).

[57]*See* nn. ____, *supra* and accompanying text (explaining distinction between horizontal and vertical ancillary restraints).

[58]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 266 ("No matter how large a margin is created by resale price maintenance, there appears to be no incentive for competitive free riding retailers to supply the particular service desired by the manufacturer."); *id.* at 277 ("Clearly if resale price maintenance is to be effective, the manufacturer must monitor the most obvious forms of non-price competition that are the closest substitutes for price reductions."). *See also*, *e.g.* Illinois Corporate Travel v. American Air Lines, 806 F.2d 722, 727-28 (7th Cir. 1986) (explaining that travel agents circumvented price regulation by bundling low-priced services with tickets).

[59]*See* Klein, *Distribution Restrictions*, 7 S. CT. ECON. REV. at 7, n. 11 ("Minimum resale price maintenance, by itself, will not assure that dealers will supply the quantity and types of service desired by the manufacturer. Telser begs this question by artificially assuming that the promotional services desired by the manufacturer are the only type of non-price competition dealers can engage in. Once there are alternative forms of non-price dealer competition, dealers have the ability and incentive to engage in "classic dealers free riding" on other dealers' promotional activities by supplying customers with other non-price services that amount to an effective price reduction.").

such a restraint, *i.e.*, prevent dealers from engaging in undesirable forms of non-price competition, there is no guarantee that higher resale prices will result in the promotional activities the manufacturer hopes to induce. According to Klein and Murphy, a dealer could simply choose to "pocket" any premium that the restraint creates, without providing any promotional services whatsoever.[60] Absent some other method of inducing dealers to produce such services, it is said, intrabrand restraints may simply confer a windfall on dealers while at the same time raising the manufacturer's cost of distribution.[61] If this is the case, one would not expect manufacturers to adopt and police such restraints unless they were designed to obtain or protect market power.[62]

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[60]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 266 ("Even if non-price competition is unidimensional, retailers may merely take the additional money created by the vertical restraint and continue to free ride."). *See also* Robert Pitofsky, *In Defense Of Discounters: The No Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L. J. 1487, 1493 (1983) ("There is no guarantee that the dealer, once its resale price is raised, will know exactly what kind and what amount of service the manufacturer has in mind.").

[61]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 266. *See also* POSNER, ANTITRUST LAW, at 147 ("The difference between the price at which the manufacturer sells to the dealer and the dealer's price to the consumer is the manufacturer's cost of distribution.").

[62]*See*, *e.g.*, SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 293-94 (explaining how intrabrand restraints can facilitate collusive behavior between manufacturers); Pitofsky, *Why Dr. Miles Was Right*, 8 Regulation at 28 (suggesting that minimum rpm is often symptomatic of a dealer cartel). *See also* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ____ (absent a plausible legitimate justification, it is proper to presume that a restriction on competitive rivalry is designed to exercise market power).

Klein and Murphy suggest at one point that *exclusive territories* (but not minimum rpm) at least *can* induce dealers to engage in an optimal mix of pre-sale promotional services. *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 273. This suggestion seems inconsistent with the authors' previous assertion that "[v]ertical restraints, by themselves, do not create a direct incentive for retailers to supply desired services." *Id.* at 266. Moreover, despite this suggestion, Klein and Murphy also state that their "performance bond" theory of vertical restraints applies to "any situation" where it is not economical for the manufacturer to write an explicit contract governing a dealer's service obligations. *See id.* at 267. Such "situation[s]," of course, include those situations to which Professor Telser applied his special service theory. *See* nn. ____, *supra* and accompanying text. *See also* Telser, *Fair Trade*, 3 J. L. & ECON. at 92-95 ("special services" rationale for minimum

At one level this critique of Professor Telser's analysis could undermine the generally favorable attitude toward intrabrand restraints, and some scholars have treated it that way.[63] Indeed, even before Klein and Murphy published their thesis, scholars were raising some of the same objection's to Telser's theory.[64] Nonetheless, Klein and Murphy have done more than critique the standard argument: they have also offered their own (benign) account of intrabrand restraints, an account that purports to explain a far wider range of such restraints than Telser's special services argument.[65] According to these scholars, intrabrand restraints serve as private enforcement mechanisms that supplement the imperfect remedies that the state affords to manufacturers and

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rpm applies only in those circumstances in which the alternative of contracting for such services is prohibitively expensive).

In the end, then, the exact scope of Professors Klein's and Murphy's critique of Professor Telser's "standard account" is unclear. On the one hand, these authors purport to offer a critique of the "standard economic analysis" of "vertical restraints," which they treat as "fundamentally flawed." *Id.* at 266. On the other hand, as just explained, these two authors also seem to admit that the standard account is sound when it comes to exclusive territories.

[63]*See*, *e.g.*, SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 305-306 (suggesting that "use of a distribution restraint, unless tied to contractual commitments, will not assure any change in the retailer's performance"), *citing* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 266. It should be noted that Professors Sullivan and Grimes do not discuss Klein's and Murphy's account of the procompetitive benefits of such restraints.

[64]*See, e.g.*, Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29 (characterizing as "nonsense" the claim that minimum rpm will induce dealers to provide "the right service in the right amount at the right time.").

[65]*See* nn. ____, *supra* and accompanying text (explaining that Professor Telser's approach only purports to explain a subset of intrabrand restraints). *See also* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 267 ("Our theory of vertical restraints is shown to be applicable to *any* situation where it is not economical for the manufacturer to write an explicit contract with its dealers regarding some aspect of desired dealer performance.") (emphasis added).

others through public contract law.[66] By guaranteeing dealers a higher return, it is said, intrabrand restraints can create a future stream of income that dealers would forfeit if terminated.[67] This stream of income serves as a sort of "performance bond" or "hostage" that manufacturers may take from a dealer that does not live up to its contractual obligations, including obligations to produce promotional services.[68] Moreover, in order to induce the dealer to stay loyal, the manufacturer must

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[66]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 267-28 ("We take as the starting point of our analysis the same assumption implicitly taken for granted by the special services free-riding analysis, namely, that it is not economically feasible for a manufacturer to write an explicit, enforceable contract with a dealer for the supply of desired dealer services. We assume that . . . an explicit contract regarding [dealer] performance cannot be made because dealer performance may be prohibitively costly to measure and to specify in a way that contractual breach and the extent of damages can be proven to the satisfaction of the court.").

[67]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 269-76. *See also*, *e.g.*, POSNER, ANTITRUST LAW, at 172 (invoking Klein and Murphy for the proposition that distribution restraints can "ensure the loyalty and honesty of retailers by guaranteeing them a profit greater than what pure competition would produce."); Patrick J. Kaufmann and Francine LaFontaine, *Costs of Control: The Source Of Economic Rents For McDonald's Franchisees*, 37 J. L. & ECON. 417 (1994) (relying in part on Klein and Murphy model to interpret various aspects of McDonalds' franchise system); Andrew N. Kleit, *Efficiencies Without Economists: The Early Years Of Resale Price Maintenance*, 59 S. ECON. J. 597, 599-600 (1993) (outlining Klein and Murphy approaches as one possible explanation of such restraints); Goldberg, *Free Riding And Retailing*, 79 NW. U. L. REV. at 749 (arguing that vertical restraints can be methods of providing dealers with deferred compensation that they will forfeit if terminated). It should be noted that, while Judge Posner invokes the Klein and Murphy account of distribution restraints, he does not reject the Telser account, as they do. *See* POSNER, ANTITRUST LAW, at 172-75. Nor does he offer a defense of Telser against the Klein and Murphy critique. This article supplies such a defense and also explains why the Telser and Klein and Murphy accounts are not mutually exclusive. *See* nn. ___, *infra*, and accompanying text.

[68]*See* Klein and Murphy*, Vertical Restraints,* 31 J. L. & ECON. at 268 ("The potential loss of this future quasi-rent stream takes the place of a potential court-imposed sanction in ensuring dealer performance."); *id.* at 274-76; Goldberg, *Free Riding And Retailing*, 79 NW. U. L. REV. at 749 ("If the privilege of continued future dealing with a particular manufacturer is a valuable asset, the retailer, in effect, puts up that asset as the bond for its performance. The greater the value of that asset (the higher the rewards of dealing with the manufacturer), the more the retailer risks by acting against the manufacturer's interests or orders."). *See generally* Klein, *Transaction Cost Determinants Of Unfair Contractual Arrangements,* 70 AMER. ECON. REV. at *passim*; Oliver

tailor the restraint so as to allow the dealer to exercise a portion of the market power that the manufacturer possesses due to product differentiation.[69] Like Telser, then, Klein and Murphy assume that such restraints result in higher prices. But, the source of the increase is not simply the cost of producing information; it also includes the exercise of some market power by dealers.[70]

Of course, the mere existence of a performance bond does not encourage dealers to produce special services or, for that matter, anything else. Instead, a performance bond can only encourage a dealer to perform those obligations that it undertakes. Under this view, intrabrand restraints can only encourage special services if the parties understand that the dealer is under an obligation to provide the particular services desired by the manufacturer.[71] This obligation need not be enforceable "in court;" it may instead take the form of an implicit contract.[72] Moreover, it is not

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Williamson, *Credible Commitments: Using Hostages To Support Exchange*, 73 AMER. ECON. REV. 519 (1983).

[69] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 274-76 (arguing that exclusive territories will not suffice to induce dealer promotion unless the territory confers market power that the dealer would forfeit after termination by the manufacturer.). *See generally* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 36-37 (sketching economics of product differentiation). It should be noted that Professor Telser assumed that the "special services argument" would only apply in those cases in which a manufacturer was selling a differentiated product and thus possessed market power. *See* Telser, *Fair Trade*, 3 J. L. & ECON. at 95-96. He did not, however, argue that minimum rpm that induced special services caused dealers to price above *their* costs. *See* nn. ___, *supra* and accompanying text (explaining that Professor Telser's approach does not imply that minimum rpm induces dealers to price above cost).

[70] It should be noted that, under the Rule of Reason, proof that a restraint results in an exercise of market power suffices to establish a *prima facie* case. *See* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ____ (collecting judicial, scholarly, and administrative authorities to this effect).

[71] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 282-85.

[72] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 267-68; *see also* Klein, *Unfair Contractual Arrangements*, 70 AMER. ECON. REV. at 360.

enough that the parties subjectively understand the obligation to exist: the manufacturer must also be willing to police and enforce a dealer's compliance with it.[73] Only then will intrabrand restraints "cause" dealers to provide promotional services, in the same way that, for instance, the threat of an action for breach of contract would, if the legal system functioned smoothly.[74]

As noted above, Professors Klein and Murphy purport to explain more restraints than can be explained by Professor Telser's "special services" argument. In particular, these scholars argue that manufacturers can employ intrabrand restraints to enforce *any* obligation that dealers might incur, including, but not limited to, the obligation to provide promotional services.[75] Indeed, the case study

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[73]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 269 (use of vertical restraints as a performance bond requires manufacturer to make a credible commitment to terminate shirking dealers).

[74]Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 285 ("In any event, the manufacturer must always monitor dealer performance and terminate dealers who violate the implicit contractual understanding regarding the supply of promotional services."). *See also* Kleit, *Efficiencies Without Economists*, 59 S. ECON. J. at 599 ("[Under the Klein and Murphy model], if the retailer 'misbehaves' the manufacturer cuts off its supply of goods, thus denying the retailer the stream of RPM-induced quasi-rents.").

Klein and Murphy also claim that intrabrand restraints provide dealers with a "payment" to compensate them for the provision of such services. *See id*. at 285. It is not clear why such a payment is necessary. If manufacturers do, as Klein and Murphy claim, enforce such obligations via the threat of termination, then all dealers will incur the cost of such obligations and include that cost in the price they charge consumers. Thus, if manufacturers induce dealers to provide performance bonds through intrabrand restraints or otherwise, there is no need to "purchase" promotional or other services from dealers.

[75]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 280 ("Both minimum resale price maintenance and nonprice restraints, such as exclusive territories, assure dealer performance of elements of the contractual understanding that are not enforceable in court."); *id*. at 267 ("Our theory of vertical restraints is shown to be applicable to *any* situation where it is not economical for the manufacturer to write an explicit contract with its dealers regarding some aspect of desired dealer performance.") (emphasis added); *id.* at 265 (noting that Professor Telser's "standard analysis" applies "when it is not feasible for a manufacturer to write explicit, court-enforceable contracts with retailers for the supply of particular services."). *See also* Kleit, *Efficiencies Without Economists*, 59 S. ECON. J. at 599 (describing various obligations, including obligation to provide pre-sale service,

these scholars employ to illustrate their analysis involves a manufacturer's attempt to protect its goodwill by maintaining the quality of beer that requires certain forms of rotation and storage at the wholesale and retail levels.[76] Left to their own devices, it is said, dealers may shirk these responsibilities, realizing that other dealers, and the manufacturer, will internalize most of the harm that results.[77] By conferring exclusive territories or setting a minimum price, they argue, a firm can create a mechanism for enforcing guidelines governing a dealer's handling of the product.[78] While such guidelines prevent a form of dealer shirking, they do not induce production of pre-sale promotion as envisioned by Telser's "special services" theory.[79] According to Klein and Murphy,

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that vertical restraints serve to enforce under the performance bond theory); Telser, *Fair Trade*, 3 J. L. & ECON. at 92-95 (explaining that minimum rpm is only necessary when parties cannot write explicit contracts governing pre-sale promotion).

[76]In particular, Klein and Murphy analyze Coors' decision to impose exclusive territories and maximum resale price maintenance on retailers selling Coors beer. According to these scholars, Coors adopted these restraints to create a mechanism for enforcing retailers' obligations to refrigerate and rotate Coors' product. *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 280-82. Absent some enforceable obligation, dealers could shirk their responsibilities to maintain product quality, knowing that other dealers and the manufacturer would bear part of the reputational cost that such shirking would create. *See id.* at 281. *See also*, *e.g.*, James A. Brickley, *Incentive Conflicts And Contractual Restraints: Evidence From Franchising*, 42 J. L. & ECON. 745, 748-49 (1999) (explaining how franchisees often lack sufficient incentives to invest in product quality because some portion of the benefits of such investment will accrue to other franchisees); Benjamin Klein & Lester F. Saft, *The Law and Economics Of Franchise Tying Contracts*, 28 J. L. & ECON. 345 (1985) (explaining how franchisors can employ tying contracts to ensure that franchisees utilize quality inputs); Paul H. Rubin, *The Theory of The Firm and the Structure of the Franchise Contract*, 21 J. L. & ECON. 223 (1978).

[77]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 280-82.

[78]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 280-82.

[79]While such shirking would be a form of free-riding, it would not be the sort of free riding on promotional expenditures by fellow dealers that Telser identified. *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 281 ("It is clear that refrigeration and product rotation services do not fit the standard 'consumer free-riding' paradigm."); Telser, *Fair Trade (II)*, 33 J. L.

then, intrabrand restraints can be procompetitive even when the product is such that there are no pre-sale promotional services to provide.[80] In a sense, then, the "performance bond" account of intrabrand restraints actually bolsters the presumption in favor of such agreements.

While the "special services" and "performance bond" accounts of intrabrand restraints are in obvious tension with one another, they both share some commonalities. For one thing, both accounts take as a given the boundaries of the firms employing intrabrand restraints. In other words, like price theory, both accounts take as an unexplained datum the decision by a manufacturer to rely upon the market to distribute its goods.[81] Neither asks *why* a manufacturer might choose to rely upon the market for this purpose. Moreover, both accounts rest on the assumption that reliance upon independent dealers will result in a market failure in the form of inadequate promotional expenditures. Furthermore, both accounts can be extended to explain certain intrabrand restraints

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& ECON. at 410-11 (agreeing with Klein and Murphy that the Coors example "is not a valid instance of the special service argument"). *See also* Kleit, *Early Years of Resale Price Maintenance*, 59 SO. ECON. J. at 598-600 (describing such shirking as involving a "vertical externality" and distinguishing this externality from the "horizontal" externally posited by Professor Telser).

[80] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 281 (explaining how intrabrand restraints can be part of a scheme to induce dealers to maintain product quality even where investments in quality do not constitute "special services" of the sort emphasized by Telser).

[81] *See* nn. ____, *supra* and accompanying text (explaining that price-theoretic approach to industrial organization took the boundaries of firms as a given, determined by technological considerations). *Cf.* WILLIAMSON, ECONOMIC INSTITUTIONS, at 7 (explaining how neoclassical price theory often took the boundaries of the firm as a technologically-determined given); George Stigler, *The Division of Labor is Limited By the Extent of the Market*, 59 J. POL. ECON. 185, 185 (1951) (asserting that economic theory "generally treated as a (technological?) datum the problem of what the firm does — what governs its range of activities and functions."). *See also* nn. ____, *supra* and accompanying text (explaining how price theory's dominance of industrial organization supported the so-called "inhospitality tradition" of antitrust).

that are horizontal, such as a joint venture's imposition of exclusive territories on members who distribute its products.[82] Thus, both support a presumption that such restraints are procompetitive.[83]

Finally, both accounts share another common thread: both apparently rest on what might be called a "planning" view of such restraints. That is to say, both accounts assume — consistent with price theory — that the manufacturer possesses the knowledge required to determine what sorts of special services dealers should perform.[84] As just explained, the Klein and Murphy view depends upon a claim that manufacturers and dealers agree — explicitly or implicitly — that dealers must provide promotional services designated by the manufacturer.[85] Under this approach, intrabrand restraints are simply one method of "supporting" an independent contractual obligation, a method

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[82]*See* Meese, *Quick Look*, 68 ANTITRUST L. J. at 479-81 (relying upon Telser's analysis to explain such restraints).

[83]To be sure, both the Telser and Klein and Murphy accounts are merely "exemplifying theories," that is, they simply establish that such restraints can or may be procompetitive in some circumstances. *See generally* Franklin Fischer, *Games Economists Play: A Non-Cooperative View*, 20 RAND. J. ECON. 113, 117-18 (1989) ("exemplifying theory does not tell us what *must* happen. It tells us what *can* happen.") (emphasis in original). Still subsequent empirical work suggests that a presumption in favor of vertical restraints is well-justified. *See* Telser, *Fair Trade (II)*, 33 J. L. & ECON. at 410 (suggesting that well over half such restraints are designed to combat free riding by dealers) (*citing* PAULINE M. IPPOLITO, RESALE PRICE MAINTENANCE: ECONOMIC EVIDENCE FROM LITIGATION, 76 (1988)); *see also* THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (1983).

[84]*See* nn. _____, *supra* and accompanying text (explaining that price theory assumed that firms and individuals could costlessly gather and transmit knowledge).

[85]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 285 ("In the absence of vertical integration, the manufacturer must adopt a marketing arrangement that assures the supply by dealers of a greater level of promotional services than those dealers would voluntarily supply. The manufacturer accomplishes this by creating an implicit contractual understanding with the dealer whereby the dealer agrees to provide the desired level of promotional services in exchange for payment from the manufacturer."); *id.* ("the manufacturer must always monitor dealer performance and terminate dealers who violate the implicit contractual understanding regarding the supply of promotional services.").

that is indistinguishable from a performance bond or liquidated damages provision.[86] If contract law provided perfect and costless remedies for a dealer's breach of such obligations, no such bond would be necessary.[87]

Similarly, Professor Telser asserts that minimum rpm is a method of ensuring that dealers provide services envisioned by the manufacturer. In his seminal article, for instance, Telser claimed that there are "special services" "that the *manufacturer thinks necessary* to sell his product."[88] Dealers will not provide such services, he said, unless the manufacturer sets and enforces prices sufficient to cover their cost.[89] At the same time, however, Telser's work did not explain just how,

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[86]It should be noted in this regard that Klein and Murphy state that "measurement problems" prevent the manufacturer and dealer from agreeing on an enforceable promotional obligation. *See id.* at 285. While these two scholars do not elaborate on the nature of these problems, they apparently assume that the manufacturer would know what to measure, *i.e.*, would know what sort of service it would want a dealer to provide. Otherwise, the manufacturer would have no basis for terminating a dealer and thus depriving it of the performance bond.

[87]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 267. *See also* WILLIAMSON, ECONOMIC INSTITUTIONS, at 168-69 (resting analysis of "hostages" and self-enforcing agreements on assumption that judicial enforcement of agreements is non-existent); Klein, *Unfair Contractual Arrangements*, 70 AMER. ECON. REV. at 356-58 (same).

[88]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91 ("As a result [of free riding] few or none of the retailers offer the special services the *manufacturer thinks necessary* to sell his product.") (emphasis added). *See also* Telser, *Fair Trade (II)*, 33 J. L. & ECON. at 409 ("A manufacturer wants a distributor to furnish a potential customer with special services associated with the product. Typically these are point-of-purchase sales promotions or information about the particular product."). Professor Williamson has characterized Telser's approach as assuming that dealers agree to provide "specified minimum services" including advertising, in return for an intrabrand restraint. *See* Oliver E. Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PENN. L. REV. 953, 976 (1979).

[89]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91-92. *See also* Williamson, *Assessing Vertical Market Restrictions*, 127 U. PENN. L. REV. at 976-78 (suggesting that intrabrand restraints accompany specified dealer obligations, including obligations to advertise).

say, manufacturers would acquire the knowledge necessary to determine which services they desire. Nor did he explain how minimum rpm would induce dealers to produce these particular services.[90]

Telser's discussion of possible alternatives to minimum rpm confirms his assumption that such a restraint is a method of assuring the production of services envisioned by the manufacturer. According to Telser, the chief alternative to maintained prices is a scheme whereby a manufacturer offers its product to dealers at two different prices: a low price for those dealers that agree to provide "the special service" sought by the manufacturer, and a high price to those that decline to make such

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[90]Indeed, when challenged on this point by Klein and Murphy, Telser simply repeated an unsupported assertion that minimum rpm would induce dealers to engage in "the" special services desired by the manufacturer:

> "The manufacturer may eliminate free-riding by imposing on all distributors a minimum resale price set at a level high enough to remunerate for the cost of *the* special services. The customer has no incentive to seek the product from another distributor at a lower price because, by hypothesis, no distributor can offer it at a price below the minimum set by the manufacturer. One distributor cannot free load on another, and each obtains an incentive to supply *the* special services jointly with the physical product because only in this way can they sell the product. Moreover, distributors must compete for customers by providing *the* special services. The conclusion is this: the minimum resale price is a means of attaining an efficient equilibrium when the circumstances for special services apply."

See Telser, *Fair Trade* (II), 33 J. L. & ECON. at 410 (emphasis added). Thus, Professor Telser assumes that manufacturers will set prices at a level "high enough" to provide "the" services that the manufacturer desires. Presumably, then, the manufacturer will know the cost of the services it wishes the dealer to provide. Finally, Professor Telser apparently assumes that, to obtain customers, dealers will engage in non-price competition, and that competition will just happen to be the "special services" desired by the manufacturer.

Professor Marvel, who defends the Telser approach against the Klein and Murphy critique, characterizes Professor Telser's approach as follows, *viz.* "Once attractive margins are offered through RPM, dealers will compete for those margins in ways that work to the manufacturer's interest." *See* Marvel, *Resale Price Maintenance Controversy*, 63 ANTITRUST L. J. at 64-65. Under this view, he says, minimum rpm is "self-monitoring." *See id.* at 64. Like Professor Telser, however, he does not respond to the claim that minimum rpm will lead to forms of non-price competition that is not desired by the manufacturer, or that dealers will simply "pocket" the premium created by such restraints.

a promise.[91] Such a scheme, of course, would require the manufacturer to determine in advance the precise services it wished the dealer receiving the lower price to agree to provide and to communicate this knowledge to dealers.[92] Or, Telser said, the manufacturer could "accomplish the same thing" by "paying retailers directly an amount equal to the special services they provide."[93] This assumes, of course, that the manufacturer knows what services dealers should provide, as well as the costs of these services, and can therefore price them accordingly.[94] Each such alternative would require a manufacturer to monitor the behavior of its dealers to determine whether, in fact, they provided "these requisite services."[95]

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[91]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 93 ("Let those who agree to provide special services jointly with the product pay a lower price at the factory gate than those who do not provide the special services.").

[92]Such a scheme would be indistinguishable from a manufacturer's decision to offer two different distributorship agreements — one (low priced) agreement that contains provisions deterring opportunism, and one (high priced) agreement that allows distributors to behave as they please. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 23-29, 32-35 (contending that a potential victim of opportunism will charge its trading partner a relatively low price if the partner agrees to contractual provisions that will attenuate opportunism); Meese, *Price Theory And Vertical Restraints*, 45 UCLA L. Rev. at 187-88 (manufacturer can induce dealer to agree to intrabrand restraint by charging higher prices to dealers that decline to enter such agreements); Alan J. Meese, *Tying Meets The New Institutional Economics*, 146 U. PENN. L. REV. 1, 69-70 (1997) (seller can employ discounts to induce buyer to enter tying contract that obviate opportunism by the latter).

[93]Telser, *Fair Trade*, 3 J. L. & ECON. at 94.

[94]To be sure, a manufacturer could simply promise *ex post* payment for all "promotional" expenses that a dealer could document. However, such an approach would create an obvious moral hazard, as dealers would not internalize the cost of promotion and would thus overspend on promotional activities. Thus, the manufacturer would want to limit such reimbursement to those activities that it deemed cost-beneficial. Presumably the manufacturer would not pay for those services that it deemed unhelpful or counterproductive.

[95]Telser, *Fair Trade*, 3 J. L. & ECON. at 94 ("[The manufacturer would need to check the performance of the retailers to be sure that they actually provide the requisite services."); *id*. (such an approach would require the manufacturer "to survey retailers to see that they do indeed provide

According to Telser, each of these alternatives would produce the same result, *i.e.*, the same amount and type of promotion, as minimum rpm.[96] Thus, he said, minimum rpm is only superior to these alternatives insofar as it may be cheaper to *enforce* than, say, direct payments to dealers in return for services.[97] In other words, Professor Telser apparently assumed that manufacturers who choose to employ minimum rpm could readily determine the exact form of promotion they desired and, if they wished, communicate these expectations to dealers. Minimum rpm was superior only because it did not require manufacturers to monitor compliance with such expectations.[98]

Tellingly, then, Professor Telser assumed that minimum rpm would induce the exact same mix of promotional services as an explicit contract governing a dealer's precise service obligations. He did not explain how, exactly, minimum rpm would have this effect. Nor did he consider the possibility subsequently suggested by Klein and Murphy, namely, that dealers might choose to engage in forms of non-price competition not desired by the manufacturer. Indeed, in a response to the Klein and Murphy critique, Telser simply repeated his assertion that minimum rpm would lead dealers to produce "the" promotional services desired by manufacturers.[99]

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the special services and do not simply fritter away the direct payments.").

[96]*See id*. at 93 (differential pricing scheme can "obtain the same result as by imposing resale price maintenance on the retailers"); *id*. at 94 (manufacturer can accomplish "the same thing" as a differential pricing scheme by "paying distributors directly to provide services"). It should be noted that Telser did mention one possible distinction between minimum rpm and these alternatives. Minimum rpm, he said, would compensate distributors only to the extent that the special services they provided resulted in actual sales. *See id.* at 94 (characterizing this phenomenon as an "advantage" of price maintenance).

[97]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 94.

[98]*See* Telser, *Fair Trade*, 3 J. L. & ECON. 92-94.

[99]*See* n. ____, *supra*.

B. Dissents From The Benign Accounts

As noted earlier, some scholars still cling to the inhospitality tradition, disputing the claim that intrabrand restraints are generally efficient.[100] While these scholars have focused their criticisms on Professor Telser's account, some of their criticisms apply with equal force to the account offered by Professors Klein and Murphy. At least some of these criticisms react to the "planning" assumption inherent in each approach. Moreover, while these scholars usually focus their attention on *vertical* intrabrand restraints, their critiques are equally applicable to those that are horizontal in nature.[101]

For instance, to some, the Telser account imputes a certain degree of (unrealistic) omniscience to the manufacturer. After all, this account — as well as the challenge by Klein and Murphy — both rest upon a claim that the manufacturer knows what type of "special services" a dealer should provide in local markets, as well as the cost of such services.[102] As a result, some say, minimum rpm and other intrabrand restraints are tantamount to coercive central planning, albeit under the guise of private contract.[103] A better policy, it is said, would allow "the market," *i.e.*,

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[100]*See* nn. ____, *supra* and accompanying text.

[101]*See, e.g.*, nn. ____, *infra* and accompanying text (explaining that critique based on purported less restrictive alternatives is equally applicable to horizontal restraints).

[102]*See* nn. ____, *supra* and accompanying text (explaining how both such approaches rest upon a "planning" approach to these restraints).

[103]*See* Pitofsky*, No Frills Case For The Per Se Rule Against Vertical Price Fixing,* 71 GEO. L. J. at 1493 ("authorizing the manufacturer to decide what mix of products and service is desirable, instead of allowing the market to decide that question, is inconsistent with the nation's commitment to a competitive process."); SULLIVAN, ANTITRUST LAW, at 381-82; Sullivan, *et al.*, Petitioner's Brief in Continental T.V. v. G.T.E. Sylvania, 433 U.S. 36 (1977) (No. 76-15). *See also* Eleanor Fox, *The Modernization Of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1184 (1981) ("The *per se* rule against vertical price fixing reflects the value that sellers of goods should have the

unfettered choice by dealers, and not a distant administrator, to determine the level and type of promotional services, as well as resale prices or areas of exclusivity.[104] Such an approach, it is said, would ensure that those closest to the situation make promotional decisions and thus honor antitrust's commitment to the allocation of resources by a "competitive process."[105]

Some scholars have also questioned the Telser account along the lines emphasized by Klein and Murphy, arguing that there is no guarantee that minimum rpm will in fact induce dealers to provide any promotional services; dealers might instead simply pocket the premium that restraints

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freedom to charge the price they see fit."). To be sure, this critique rests in part on a normative conception of antitrust law that values "freedom" from contractual restraint for its own sake. However, as I have shown elsewhere, this "normative" approach to intrabrand restraints in fact rests upon certain purely economic (descriptive) assumptions about retail markets. *See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. Rev. at 172-84.

[104]*See* Flynn, *The Is and Ought of Vertical Restraints*, 71 CORNELL L. REV. at 1138-42; Pitofsky, *Why Dr. Miles Was Right,* at 29 ("If we should now permit suppliers to fix resale prices for all stores that sell their product, we would in effect be turning over to suppliers the decision on the amounts and kinds of service that are needed. It is far better, in my opinion, to leave that decision to the free market."); SULLIVAN, ANTITRUST LAW, at 382 ("There is an extravagant arrogance on behalf of manufacturers for them to claim that, despite their lack of involvement and experience at the resale level, they can better identify the optimum price, scale and level of promotion at that level, even though acting without the information which would be yielded by a competitive distribution system, than could dealers, involved and experienced there and possessed of that market information."); *id.* at 386 ("Manufacturer justifications have one common characteristic — they presuppose that an administered decision, a centralized decision made by the manufacturer and which governs all dealers, will in some sense be better than decisions made by dealers in the competitive marketplace.").

[105]*See* Pitofsky, *No Frills Case For The Per Se Rule Against Price Fixing*, 71 GEO. L. J. at 1493. *See also*, *e.g.*, SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 14-16; Fox, *Modernization of Antitrust,* 66 CORNELL L. REV. at *passim* (arguing that antitrust laws should protect and implement a decentralized "competitive process"). *See also* Flynn, *The Is and Ought of Vertical Restraints*, 71 CORNELL L. REV. at 1138-42.

create.[106] Others have questioned whether dealers subject to such a restraint will engage in the sort of non-price competition desired by the manufacturer, instead of some other sort of competition.[107] Indeed, the immediate past Chairman of the Federal Trade Commission termed "nonsense" the claim that minimum rpm would induce dealers to produce the pre-sale services "desired by the manufacturer."[108] For these scholars the absence of any account of *how* intrabrand restraints induce dealers to produce appropriate types and amounts of promotion undermines any presumption that such restraints are procompetitive.[109]

Indeed, for some, the absence of a contract or other provision delineating what sort of services the manufacturer expects suggests that the restraint in question simply does not induce the provision of promotional services.[110] After all, if manufacturers have expectations that intrabrand

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[106]*See, e.g.*, Carstensen, *Distribution Restraints*, 69 ANTITRUST L.J. at 606 (contending that intrabrand restraints are susceptible to cheating and therefore produce few net benefits); SULLIVAN AND GRIMES, LAW OF ANTITRUST, 305-306.

[107]*See* Pitofsky, *The No Frills Case For The Per Se Rule Against Vertical Price Fixing,* 71 GEO. L. J. at 1493.

[108]*See* Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29 ("A manufacturer decides its dealers should be supplying more service. But instead of discussing this with its dealers, instead of contracting with dealers for more service, instead of providing the service itself, the manufacturer imposes vertical price-fixing. And it does this confident that the dealers will know that it wants them to respond by offering specific services, for example, a longer warranty or point of sale advertising. So the manufacturer fixes the retail price and, presto, the dealer comes up with the right service in the right amount at the right time. In my view this scenario is nonsense.").

[109]*See* nn. ____, *supra* and accompanying text.

[110]*See* SULLIVAN AND GRIMES, LAW OF ANTITRUST, 306 ("If a retailer chooses not to provide these amenities [desired by the manufacturer], use of a distribution restraint, unless tied to contractual commitments, will not assure any change in the retailer's performance."); Business Electronics v. Sharp Electronics, 485 U.S. 717, 739-48 (1988) (Stevens, J. dissenting) (arguing that agreement to terminate price cutting dealer should be unlawful *per se* absent accompanying agreement on promotional services that the distributor should provide).

restraints will lead dealers to produce particular "special services," and if an intrabrand restraint cannot itself induce such services, then one might expect the parties to memorialize these expectations in some fashion that communicates the expectation to dealers.[111] Failure to do so, it might seem, could place a dealer at risk of arbitrary termination — a risk the manufacturer would find incorporated in the (reduced) price it could charge for its product.[112] For some, then, the absence of express provisions regarding the promotional efforts desired by the manufacturer calls into question a manufacturer's claim that an intrabrand restraint is designed to overcome market failure

[111]Such memorialization would not necessarily create a contract plausibly enforceable in the courts. It would, however, give distributors some notice of what sort of promotional services manufacturers expect them to provide. The performance bond theory view implies that a manufacturer that did not provide such guidance would suffer in the marketplace, as dealers came to fear that they would be victims of arbitrary termination.

[112]*See* Alan J. Meese, *Regulation Of Franchisor Opportunism And Production Of The Institutional Framework: Federal Monopoly Or Competition Between The States*?, 23 Harv. J. L. & Pub. Pol. 61, 71 (1999); Benjamin Klein, *Market Power in Antitrust: Economic Analysis After Kodak*, 3 Sup. Ct. Econ. Rev. 43 (1993). *See also* Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. Chi. L. Rev. 1, 29-32 (1993) (asserting that rules requiring disclosure of onerous contractual terms will cause parties to price such terms); Klein, *'Unfair' Contractual Arrangements*, 70 AMER. ECON. REV. at 360.

by inducing the production of such services.[113] Absent such benefits, the logical implication is that such restraints represent an exercise of market power to the detriment of consumers.[114]

Finally, some scholars concede for the sake of argument that reliance on dealers' unfettered discretion will not result in an efficient level of promotional services, because of the sort of opportunistic free riding identified by Professor Telser. Nonetheless, they argue, manufacturers could obtain the same level of promotion by employing contractual restraints that are less restrictive of rivalry between dealers than, say, minimum rpm or exclusive territories.[115] This critique flows naturally from the "planning" assumption inherent in Telser's analysis, an assumption explicitly embraced by Klein and Murphy. After all, if a manufacturer knows what services it desires, and can set a retail price accordingly, then presumably it can communicate these expectations to its dealers.[116]

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[113]*See Business Electronics*, 485 U.S. at 739 (Stevens, J. dissenting) (claiming, without citation of evidence, that vertical nonprice restraints "typically" involve dealer agreement to "certain standards in its advertising, promotion, product display, and provision of repair and maintenance services in order to protect the goodwill of the manufacturer's product."); *id.* at 740-742 (arguing that agreement to terminate price cutting dealer was "naked" and thus should be unlawful *per se* absent accompanying agreement on promotional services that the dealer should provide). *See also* Carstensen, *Distribution Restraints*, 69 ANTITRUST L.J. at 591 ("The free-rider explanation for overt restraints on resale competition implies the existence of a prior commitment, overt or tacit, by the reseller to provide some costly service or effort in connection with the sale. Where only [intrabrand restraints] exist, the reasonable inferences are that the producer has some market power, and the investments required are not substantially vulnerable to free riding or other opportunism."); Rudolph Peritz, *A Genealogy Of Vertical Restraints Doctrine*, 40 Hastings L. J. 511, 549-550 (1989) (endorsing Justice Stevens' reasoning on this point). By its terms, this critique cannot apply to the Klein and Murphy account, which assumes that manufacturers do, in fact, inform dealers of their respective obligations.

[114]*See, e.g.*, Carstensen, *Distribution Restraints*, 69 ANTITRUST L.J. at 591.

[115]*See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 606-609; Pitofsky, *The No-Frills Case For The Per Se Rule Against Vertical Price Fixing*, 71 Geo. L. J. at 1493.

[116]*Cf.* nn. ____, *supra* and accompanying text (explaining that Professor Telser apparently assumed that a manufacturer can costlessly determine dealers' optimal promotional strategy).

In some cases such alternatives consist simply of less onerous contractual restrictions. So, for instance, some scholars have argued that a manufacturer could assign dealers so-called "areas of primary responsibility" instead of airtight exclusive territories.[117] Such restraints would essentially require dealers to make their "best efforts" in particular territories while still allowing them to sell wherever they pleased.[118] Others claim that manufacturers could enter explicit contracts requiring dealers to engage in the exact promotional services desired by the manufacturer.[119] Finally, some scholars have argued that manufacturers could produce the same or greater benefits by integrating forward into the distribution function and thus engaging in such promotional activities themselves.[120]

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[117]*See*, *e.g*., Robert Pitofsky, *A Framework For Antitrust Analysis Of Joint Ventures*, 74 Geo. L. J. 1605, 1621 (1986) (arguing that "primary responsibility or profit pass-over clauses" are less restrictive means of achieving the legitimate objectives of exclusive territories); SULLIVAN, ANTITRUST, at 408 (same); White Motors Co. v. United States, 372 U.S. 253 (1963) (Brennan, J. concurring) (same). *See also* Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 699 (1962) (arguing that legitimate objectives of exclusive territories could be achieved through "less restrictive alternatives such as a clause assigning each dealer a territory of primary responsibility which he agrees to use his best efforts to develop.").

[118]*See* Turner, *Definition of Agreement Under The Sherman Act*, 75 Harv. L. Rev. at 699.

[119]*See*, *e.g*., SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 335 & n. 24; *id.* at 304-305 (identifying promotional allowances, where manufacturer pays dealer to engage in services "that the producer deems most critical"); SULLIVAN, ANTITRUST, at 386; 416 ("The manufacturer can expressly require every dealer to provide whatever display, service, or other facility, or whatever commitment to local promotional activity the manufacturer regards as needed."); Pitofsky, *The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L. J. at 1493 ("If a manufacturer really wants additional advertising, the common commercial practice is to contract separately for it. If a manufacturer wants a warranty program, the same solution applies."); Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29 (same).

[120]*See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 606-608; *id*. at 608 ("The most plausible response [to dealer free riding] will remain that of internalizing the activity within the organization in such a way that free riding is made unfeasible by the very nature of the business organization."); SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 505 (identifying vertical integration as possible less restrictive alternative); Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29

Scholars have suggested similar alternatives for horizontal intrabrand restraints.[121] For these scholars, the ready availability of alternatives that produce the same or greater benefits suggests that intrabrand restraints — whether vertical or horizontal — are generally anticompetitive.[122]

To be sure, proponents of the Telser approach have offered responses to at least some of these critiques.[123] Take the argument that intrabrand restraints involve undue interference in a dealer's decisionmaking and are thus analogous to impermissible central planning. It is certainly true that such restraints involve a manufacturer's "administration" of portions of the dealer's promotional agenda.[124] Nonetheless, such (private) "administration" occurs millions of times each day in a capitalist economy. Indeed, economists generally treat the presence of "administration" as the

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(same).

[121] *See* SULLIVAN AND GRIMES, LAW OF ANTITRUST, at 223 (endorsing less restrictive alternative test as applied to horizontal intrabrand restraints); Pitofsky, *Antitrust Analysis of Joint Ventures*, 74 GEO. L. J. at 1621(suggesting that venture partners can achieve legitimate objectives of exclusive territories via primary responsibility clauses). The enforcement agencies have taken a similar approach. *See* Department of Justice and Federal Trade Commission Competitor Collaboration Guidelines, § 3.36(b) (presence of less restrictive alternatives dooms restraint regardless of balance between cost and benefits).

[122] *See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L.J. at 606-608; SULLIVAN AND GRIMES, ANTITRUST LAW, at 223, 664-67; Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29.

[123] Professors Klein and Murphy have not responded to those criticisms that are applicable to their analysis. This is not surprising, since scholars and others who are hostile to intrabrand restraints have focused their critique on Professor Telser's account of such restraints. Indeed, as noted earlier, while some scholars have invoked portions of the Klein/Murphy analysis against the Telser approach, they have not addressed the assertion by these two scholars that such restraints are generally efficient. *See* nn. ___ *supra*.

[124] *See* SULLIVAN, ANTITRUST, at 381-82. *See also* nn. ____, *supra* and accompanying text.

defining characteristic of the private, capitalistic business firm.[125] More precisely, the formation of a firm entails the delegation of an individual's control over his or her labor or property to an employer, who in turn will administer such resources.[126] Unlike central planning, such a delegation is entirely voluntary, and thus presumptively efficient.[127] *A priori*, then, a dealer's delegation of authority over its promotional or pricing decisions to the manufacturer seems no more or less problematic than an employee's delegation of such authority to his or her employer.[128]

Moreover, some scholars have argued that the less restrictive alternatives that others emphasize are usually more costly to negotiate and enforce, and less effective, than straight-forward

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[125]*See*, *e.g.,* Ronald H. Coase, *The Nature Of The Firm*, 4 ECONOMICA 381 (1937); Steven N. S. Cheung, *The Contractual Nature Of The Firm*, 26 J. L. & ECON. 1, 10 (1983) (concluding that "the firm is characterized by central direction.").

[126]*See* Ronald H. Coase, *Nature Of The Firm: Meaning*, 4 J. L. ECON. & ORG. 19, 28 (1988) (stating that the firm is a "special type of contract"); Cheung, *Contractual Nature Of The Firm*, 26 J. L. & ECON. at 5 (a firm involves "a form of contract that binds the input owner to follow directions instead of determining his own course by continual reference to the market prices of a variety of activities he may perform.").

[127]*See* Victor P. Goldberg, *The Law And Economics Of Vertical Restrictions: A Relational Perspective*, 58 TEX. L. REV. 91, 107 (1978). *See also* Coase, *Nature of the Firm*, 4 ECONOMICA at 389, n.3 (noting that, even in a free market economy, there is an efficient amount of planning within private business firms).

[128]Similarly, any invocation of the "competitive process" begs the question of the appropriate definition of "competition." As I have shown elsewhere, many scholars hostile to intrabrand restraints adopt an atomistic, "technological" conception of competition, a conception that does not recognize intrabrand restraints as competitive at all. *See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. REV. at 183-95 (explaining that so-called "Populist" approach to such restraints rests upon price-theoretic model of "competition."). By contrast, reliance upon a more modern model of competition that recognizes the presence of market failures produces a far more hospitable approach to intrabrand restraints and other non-standard contracts. *See* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ____. *See also* Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 111 (noting that a manufacturer's experimentation with various vertical restraints involves "the competitive process in producing competitive results.").

minimum rpm or exclusive territories.[129] For instance, areas of primary responsibility simply require retailers to serve their own areas well; they do not prevent them from serving other areas and thus free riding on the efforts of those with primary responsibility for those territories.[130] Similarly, the claim that manufacturers could readily negotiate and enforce requirements that dealers engage in particular promotional services seems overdrawn. Such negotiations cost time and money, and rules governing the (non)-enforcement of form contracts make it difficult for parties to memorialize the manufacturer's promotional expectations.[131] Even if parties do manage to negotiate detailed promotional obligations, it is said, the manufacturer would have to incur prohibitive expenses monitoring and enforcing them.[132] Thus, these scholars conclude, intrabrand restraints such as

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[129] *See* Meese, *Price Theory And Vertical Restraints*, 45 UCLA L. Rev. at 189-95; Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 110-111; BORK, ANTITRUST PARADOX, at 290-91.

[130] *See* Meese, *Quick Look*, 68 ANTITRUST L. J. at 487, n. 109.

[131] At common law, of course, dealers were bound to whatever agreement they signed, regardless whether they were subjectively aware of the terms in question. *See* RESTATEMENT (FIRST) OF CONTRACTS, SECTION 70 (articulating so-called "duty to read" contracts); Sanger v. Dun, 3 N.W. 388, 389 (Wisc. 1879) ("It will not do for a man to enter into a contract, and, when called upon to abide by its conditions, say that he did not read it when he signed it, or did not know what it contained."). Given such a background rule, a manufacturer could simply create individualized service and promotion obligations by requiring each dealer to sign a slightly different contract. More recently, however, courts have held that, absent subjective assent, dealers and others are only bound to those provisions of form contracts that courts deem within the reasonable expectations of the parties. *See, e.g.,* RESTATEMENT (SECOND) OF CONTRACTS, § 211; Weaver v. American Oil Co., 276 N.E. 2d 144 (Ind. 1971). Indeed, even reasonable provisions of form contracts are unenforceable unless equally applicable to all parties. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 211. As a result, any manufacturer that wished to impose individualized promotional obligations on its dealers would have to ensure that the negotiation process produces evidence that the dealer did, in fact, subjectively assent to such requirements. *See* Meese, *Price Theory And Vertical Restraints*, 45 UCLA L. REV. at 193-94.

[132] *See* BORK, ANTITRUST PARADOX, at 290 ("This technique [minimum rpm or exclusive territories] is preferable to direct payment for such effort. Direct payment may be accepted and competed away in lower prices, again destroying the incentive of other outlets to provide the desired

minimum rpm and exclusive territories, while more restrictive of rivalry, are also more effective and less costly methods of solving the market failure at issue.[133] As a result, the existence of such alternatives in no way supports a presumption that such restraints are anticompetitive.[134]

These responses are not entirely satisfactory, however. For one thing, there is no obvious response to the observation that Professor Telser's account lacks a mechanism to ensure that dealers engage in particular forms of promotion "desired by the manufacturer."[135] Absent an explanation of how, exactly, intrabrand restraints overcome the market failure that Telser identified, it would be difficult to credit any claim that such restraints "presumptively" or "usually" produce the benefits Telser claimed.[136] Moreover, the recognition that planning often occurs within firms in a market economy does not explain why such planning should occur here, where the manufacturer has by

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efforts. The manufacturer would have to engage in extensive policing activities to catch such actions and would have to argue the question of whether the efforts being made were in the correct amount."); Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 107 ("[T]he quality of [retailer] service is difficult to monitor."); Telser, *Fair Trade*, 3 J. L. & ECON. at 93-95 (describing some of these enforcement costs).

[133]*See* Meese, *Price Theory And Vertical Restraints*, 45 UCLA L. Rev. at 192-93; WILLIAMSON, ECONOMIC INSTITUTIONS, at 187; Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 107, 110-111 ("The franchisor who adopts more restrictive terms probably does so because he believes those terms are more efficacious."); BORK, ANTITRUST PARADOX, at 291 (arguing that manufacturers can easily police intrabrand restraints because rival dealers can readily detect cheating by fellow dealers and will report such cheating to the manufacturer).

[134]*Cf.* nn. ____, *supra* and accompanying text (describing assertions by some scholars that existence of less restrictive alternatives gives rise to a presumption that such restraints are anticompetitive).

[135]*See* nn. ____, *supra* and accompanying text (outlining this shortcoming of Professor Telser's approach).

[136]*See* nn. ____, *supra* and accompanying text. *See also Business Electronics*, 485 U.S. at 739-48 (Stevens, J. dissenting) (absence of specific contractual service obligations undermines claim that intrabrand restraint overcomes market failure).

definition decided *not* to take on the distribution function itself, but instead to rely upon "the market," *i.e.*, *independent* dealers. Nor does it establish that most intrabrand restraints are, in fact, examples of such voluntary manufacturer planning of dealer activities. The mere identification of a market failure does not *ipso facto* establish that the state should regulate, *i.e.*, plan, to correct the failure. In some cases, the cure is worse than the disease.[137] Similarly, proof that dealers will underinvest in promotion does not in and of itself establish the need for manufacturer planning — here again the cure might be worse than the disease.[138] Indeed, some of the same economists who argue that intrabrand restraints are generally efficient have also argued that dealers' possession of local knowledge counsels against vertical integration, that is, complete planning of the distribution function.[139]

Furthermore, the response to the less restrictive alternative challenge is not as strong as it might seem. For one thing, it is not clear that less restrictive alternatives really *are* always less effective than intrabrand restraints. It is certainly true that the negotiation and policing of detailed provisions governing dealers' promotional duties can be more expensive than negotiation over a resale price or the extent of an exclusive territory. This need not always be the case, however. After

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[137]Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J. L. & ECON. 1 (1969) (explaining the so-called Nirvana fallacy, whereby advocates of regulation emphasize the failure of private markets and ignore shortcomings of government intervention). *See also* Ronald H. Coase, *The Regulated Industries: Discussion*, 54 AMER. ECON. REV. 194, 195 (1964) (pointing out that economists often emphasize the category of "market failure" but have no category of "government failure.").

[138]Economists have often recognized, for instance, that the mere identification of a market failure does not itself establish that complete integration, and with it pervasive planning within a single entity, is justified. *See* Oliver E. Williamson, *Why Law, Economics, and Organization?* 21 (2001) (unpublished working paper).

[139]*See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 109-110.

all, manufacturers that wish to impose minimum rpm or exclusive territories must presumably generate knowledge regarding the types of promotion they wish dealers to provide, *i.e.*, the promotion "desired by the manufacturer," and then calculate a corresponding price or territory that they wish to enforce. Thus, a requirement that manufacturers instead "bargain" with dealers over specific service obligations would add little or no additional cost; a manufacturer could simply memorialize its promotional expectations in a form contract. Moreover, contrary to the suggestion of Professor Telser and others, manufacturers that impose intrabrand restraints must do more than simply monitor dealers' compliance with a particular price or territorial boundary; they must also police and prevent various methods that dealers might employ to circumvent such restrictions.[140] Thus generation, communication and enforcement of specific obligations may be no more expensive than the communication and enforcement of a minimum price or exclusive territory.

At any rate, any "realization" that less restrictive alternatives are somewhat less effective does not itself establish that intrabrand restraints are superior to such alternatives from the perspective of consumers or society. Even if these alternatives are less effective, they are less restrictive of rivalry between dealers as well. Thus, while alternatives may produce fewer benefits than intrabrand restraints, they may also produce fewer harms.[141] It may well be, then, that "on balance," a less restrictive alternative advances social welfare more than an intrabrand restraint, even

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[140] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 266 (explaining that dealers can circumvent minimum rpm by providing consumers with secret discounts); Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 109-110 (explaining various steps that a manufacturer can take to prevent cheating on such restraints). *Cf.* Telser, *Fair Trade*, 3 J. L. & ECON. at 94 (assuming that manufacturers who employ minimum rpm need only "police violations of minimum prices"); BORK, ANTITRUST PARADOX, at 291 (contending that such restraints are easy to police because other dealers will readily report instances of cheating).

[141] *See* n. ____, *supra* (outlining some of the possible harms of intrabrand restraints).

if the latter is somewhat more effective. Such reasoning, it seems, underpins the assertion by some scholars that less restrictive alternatives are "protection enough" for the legitimate interests of a manufacturer or joint venture, and could support a presumption that such restraints are on the whole anticompetitive.[142]

Finally, a conclusion that intrabrand restraints usually advance social welfare more than alternatives would have modest consequences for antitrust doctrine. To be sure, this conclusion tends to rebut any argument that intrabrand restraints are always more restrictive than necessary and should therefore be unlawful *per se*.[143] Even absent *per se* treatment, however, courts must still analyze such restraints under the Rule of Reason, balancing the benefits of the challenged restraint against its harms on a case-by-case basis.[144] Under this approach, courts and most scholars agree that, once a plaintiff makes out a *prima facie* case, even a reasonable restraint should not survive

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[142]*See* Turner, *Definition of Agreement Under The Sherman Act*, 75 HARV. L. REV. at 699.

[143]*See*, *e.g.*, Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. Rev. at 189-195 (explaining that purported existence of less restrictive alternatives does not justify *per se* rule against such restraints); WILLIAMSON, ECONOMIC INSTITUTIONS, at 183-89 (presence of purported less restrictive alternatives does not justify automatic condemnation of exclusive territories). *Cf.* SULLIVAN, ANTITRUST, at 385-86 (relying in part on existence of less restrictive alternatives as a rationale for *per se* treatment of minimum rpm); nn. ____, *supra* and accompanying text (explaining that so-called inhospitality tradition once led courts to declare such restraints unlawful *per se*).

[144]Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1977) (suggesting that courts should analyze vertical restraints by balancing harms against benefits). *See also*, *e.g.*, Law v. NCAA, 134 F.3d 1010, 1019 (10th Cir. 1998) (ultimately under the Rule of Reason "the harms and benefits must be weighed against each other in order to judge whether the challenged behavior is, on balance, reasonable.") (*citing* PHILIP AREEDA, 7 ANTITRUST LAW at ¶ 1502, p. 372 (1986)); Capital Imaging v. Mohawk Valley Medical Association, 996 F.2d 537, 543 (2d Cir. 1993) (under the Rule of Reason "the factfinder weighs the harms and benefits of the challenged behavior"); 7 AREEDA, ANTITRUST ¶ 1500, p. 362-63 (Rule of Reason analysis calls for balancing); *id.* at ¶ 1502, p. 372 (same); *id.* at ¶ 1507 (same); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 257-58 (same).

scrutiny if the plaintiff can show that a less restrictive alternative will produce the same benefits.[145] Neither Professor Telser nor his defenders, then, have offered any arguments precluding the consideration of less restrictive alternatives in this manner.[146]

Perhaps more importantly, these responses do not help scholars or jurists choose between the alternate benign accounts of intrabrand restraints. Is it true, as Professor Telser seems to suggest, that the mere existence of minimum rpm will induce dealers to engage in the promotional activities anticipated and "desired" by the manufacturer? Or, instead, are Professors Klein and Murphy correct when they argue that such restraints are indistinguishable from other types of performance bonds,

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[145] *See Law*, 134 F.3d at 1019 (articulating this portion of Rule of Reason test); Capital Imaging Assoc., P.C. v. Mohawk Valley Medical Ass'n, 996 F.2d 537, 543 (2d Cir. 1993) (same); HOVENKAMP, FEDERAL ANTITRUST POLICY, at 498 (endorsing application of less restrictive alternative test as part of Rule of Reason analysis of vertical restraints); Department of Justice and Federal Trade Commission Competitor Collaboration Guidelines, § 3.36(b) (any attempt to justify apparently anticompetitive restraint is subject to a less restrictive alternative test).

It should be noted that proof that a restraint results in an exercise of market power suffices to establish a *prima facie* case for purposes of Rule of Reason analysis. *See Law*, 134 F.3d at 1019.

[146] At any rate, the argument that less restrictive alternatives are often less effective does not buttress the Klein and Murphy account of such restraints. After all, Klein and Murphy assert that manufacturers do, in fact, communicate their expectations regarding the types of special service they wish dealers to provide. Indeed, there is a sense in which the performance bond account of intrabrand restraints lends itself to the claim that "less restrictive alternatives" can achieve the same objectives as exclusive territories or minimum rpm. If a manufacturer does know what "special services" it desires, then presumably it can communicate that knowledge to its dealers. Of course, the mere communication of an implicit obligation does not by itself ensure the effective enforcement of such an undertaking. And, Klein and Murphy are certainly correct that private enforcement of a dealer's obligations is often superior to reliance upon the judicial system. However, Klein and Murphy have made no effort to explain just why such restraints are superior to other private enforcement mechanisms. For instance, manufacturers could require dealers to post actual performance bonds. Or, they could require them to make investments in training or equipment that are specific to the relationship in question. While such mechanisms are not themselves without costs, they may well be less costly than the creation and enforcement of, say, a minimum rpm agreement. At the same time, such mechanisms would involve no reduction in price rivalry between dealers.

such as an up-front franchise fee? Moreover, do such restraints really confer market power on dealers, as Klein and Murphy claim? Or, instead, do these restraints simply ensure that dealers incur the costs necessary to promote the manufacturer's product, as Telser contends? While a more charitable approach to intrabrand restraints has carried the day, at least among academics, there is as of yet no universal agreement on just how, exactly, such restraints induce dealers who are otherwise prone to free ride to produce promotional services "desired by the manufacturer."

II. A PROPERTY-BASED APPROACH TO INTRABRAND RESTRAINTS

As explained above, scholars who presume that intrabrand restraints are procompetitive do not entirely agree on just how such restraints overcome a failure in the market for distributional services. Indeed, Professors Klein and Murphy contend that such restraints do not, in fact, induce dealers to produce promotional services, any more than would an ordinary performance bond. Moreover, while Professor Telser and his followers adamantly claim that such restraints do induce dealers to produce such services, they do not explain how the restraints induce dealers to produce *the* services *desired by the manufacturer,* and not, for instance, forms of non-price competition that are actually harmful to the manufacturer or its system of distribution. At the same time, some scholars continue to assert that such restraints are presumptively anticompetitive even when conditions require the production of such services.[147] This continuing controversy suggests that it may be time for a fresh approach.

This article offers such a distinct approach, an approach that avoids the pitfalls of either benign account of intrabrand restraints. Intrabrand restraints may simply be best characterized as contracts *for property rights*, unrelated to any expectation that dealers will perform particular

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[147]*See* nn. ____, *supra* and accompanying text.

promotional services.[148] Such an assumption helps amend and thus bolster Professor Telser's account against various critiques.

As explained below, manufacturers can avoid the excessive costs of planning by relying upon the market, *i.e.*, independent dealers, to distribute their products. By relying upon such dealers, manufacturers can delegate the authority over promotional decisionmaking to those individuals with the incentives and knowledge necessary to make optimal promotional investments. Background rules of property law facilitate this process, by assigning independent dealers the presumptive right to realize the fruits of their investment in promotional activity.

Still, these background rules do not always suffice to ensure that dealers internalize the benefits of their promotional efforts, given the prospect of dealer free-riding. By adopting vertical intrabrand restraints, manufacturers that choose to rely upon the market to distribute their goods can better define dealer property rights. Under a property rights paradigm the parties contract for the intrabrand restraint — *and nothing more*. The resulting property right consists of the ability to exclude other dealers from particular valuable resources, namely, potential customers, that a dealer can locate and secure through its promotional efforts.[149] The delineation of rights in customers is not an end in itself, however, but is instead an indirect means of creating and protecting rights in a valuable but fleeting resource, namely, information. By privatizing information in this way, manufacturers can alter the structure of "the market" to achieve the best of both worlds: a decentralized system for creating knowledge regarding optimal promotional strategies and dealers

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[148] *See* GARY LIEBCAP, CONTRACTING FOR PROPERTY RIGHTS (1989).

[149] *See* YORAM BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, 3 (1997) (defining a property right over an asset as "the individual's ability, in expected terms, to consume the good (or the services of the asset) directly or to consume it indirectly through exchange.").

with the incentives to pursue such strategies without fear of free-riding. In the same way, of course, joint ventures can rely upon members to distribute their goods and employ horizontal intrabrand restraints to ensure that these members internalize the benefits of their promotional efforts.

A. The Vices Of Planning

Before considering the property rights approach in great detail, it is useful to examine the shortcomings of the sort of planning that both benign accounts impute to manufacturers. As noted earlier, both benign accounts take as a given the manufacturer's decision to rely upon the market to distribute its products.[150] Neither account, however, asks *why* a manufacturer might rely on others in this manner. It is therefore useful to begin with the assumption that the manufacturer has instead integrated forward and taken on the task of distribution itself. This assumption helps shed light on the manufacturer's decision to rely on the market to distribute its goods in the first place, and thus, it will be seen, helps explain the use of intrabrand restraints.

A firm that chose to distribute its own goods would by definition take on the task of "planning" or directing its own promotional activities.[151] An omniscient manufacturer could determine what various forms of promotion each employee should produce and then communicate these expectations to its sales force.[152] The manufacturer could also monitor employee efforts to

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[150]*See* nn. ____, *supra* and accompanying text.

[151]*See* Cheung, *Contractual Nature Of The Firm*, 26 J. L. & ECON. at 10 (reliance on firm to conduct economic activity involves "direction" by a "visible hand"); Coase, *Nature of the Firm*, 4 ECONOMICA at 387-89 (same).

[152]*Cf.* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 283-85 (contending that manufacturers communicate such expectations to dealers); Pitofsky, *In Defense Of Discounters*, 71 Geo. L. J. at 1493 (arguing that manufacturers that desire particular promotional services can contract with dealers to provide them); SULLIVAN, ANTITRUST, at 386, 416 (same).

comply with these expectations, terminating those who did not comply with the manufacturer's requirements. In this way, the manufacturer could plan or direct its promotional activities.[153]

Such intra-firm planing is analogous to that which would take place in a communist state.[154] In such a regime, an omniscient central planner could determine the optimal activities of each manufacturer and dealer and then order each to conduct them.[155] In such a world, each "independent" dealer would function as an employee of the state, taking orders from the central authorities.[156] Indeed, at one time, a significant proportion of the economics profession believed that such planning was the best way to ensure an efficient allocation of resources.[157] This enthusiasm for planning, while perplexing to modern economists, made more sense within the confines of the model of perfect competition, the foundation of the same neoclassical price theory that dominated economic thinking at the time and gave rise to the inhospitality approach to antitrust described earlier.[158] By

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[153]*See* Coase, *Nature of the Firm*, 4 ECONOMICA at 387-89 (reliance on "the firm" to conduct economic activity involves owner's "direction" or "planning" of employee activity).

[154]*See* Coase, *Nature of the Firm*, 4 ECONOMICA at 387-89 (contending that the planning that occurs within the firm is in principle no different from that undertaken in a communist state).

[155]*See*, *e.g*., Oscar Lange, *On The Economic Theory Of Socialism (Part II)*, 4 REV. ECONOMIC STUDIES 123 (1937); Oscar Lange, *On The Economic Theory Of Socialism (Part I)*, 4 REV. ECON. STUDIES 53 (1936).

[156]*Cf.* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 115 (reporting Lenin's assertion that, in a communist state, the state would run the economic system as one large factory); Coase, *Nature of the Firm*, 4 ECONOMICA at 394 (explaining that a useful theory of the firm must explain why a single firm does not conduct all economic activity).

[157]*See*, *e.g*., FRANK M. MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, 52-95 (1995).

[158]*See* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 52-95 (explaining link between perfect competition model and enthusiasm for planning among economists in the first half of the 20th century); Ronald H. Coase, *The Nature of the Firm: Origin*,

adopting various unrealistic assumptions, particularly that: 1) knowledge flows freely and costlessly between economic actors and 2) firms in a given industry share the same production characteristics, price theory's perfect competition model made planning appear to be a more realistic method of allocating society's resources.[159]

In real life, however, we tend to think that there is no such thing as an omniscient state central planner. Simply put, the real world departs in several respects from that imagined by price theory and past devotees of central planning. Knowledge is costly to acquire, and an effective planner would have to gather an enormous amount of information about the preferences of consumers in each relevant region to determine their receptivity to various possible promotional strategies. Indeed, it would not suffice for the planner to inform itself about existing customers; it would also have to acquire knowledge about potential or "marginal" customers, who would be the most sensitive to promotional activities.[160] Even if the planner could costlessly gather such information about the varied preferences and proclivities of actual and potential consumers in each relevant region, it could

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4 J. L. ECON. & ORG. 3, 8 (1988) (describing link between perfect competition model and enthusiasm for planning among some economists). *See also* Hayek, *Meaning of Competition*, at 94-96 (explaining that then-contemporary economists often adopted unrealistic assumptions associated with the perfect competition model when analyzing economic problems); nn. ____, *supra* and accompanying text (describing role of price theory in creating inhospitality tradition).

[159]*See* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 52-95; Langlois, *Transaction Costs, Production Costs, And The Passage Of Time*, at 2 ("In this kingdom [the world imagined by price theory], knowledge remains explicitly and freely transmittable, and cognitive limits seldom if ever constrain.").

[160]*Cf.* Gary S. Becker and Kevin M. Murphy, *A Simple Theory of Advertising as a Good or Bad*, 108 Q. J. ECON. 941, 955 (1993) (contending that some promotion attracts marginal consumers who did not previously purchase the brand); Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 284-85 (contending that manufacturers sometimes direct promotional efforts toward "marginal" customers who are sensitive to such promotion).

still not adequately determine appropriate forms of promotion. To make such a determination, the planner would have to understand the capabilities and costs of each of "its" dealers, and make its promotion plan accordingly. While price theorists once assumed that firms generally shared the same production technologies, and thus the same cost structure, in the real world no two retailers are alike; each has unique productive, human and reputational capacities.[161]

Of course, the central planner could avoid many of these costs by gathering and relying upon aggregate data regarding consumers and dealers. That is to say, a planner could adopt promotional guidelines that reflected the preferences of the average consumer and average dealer. Such a "one size fits all" approach would make sense if all consumers and dealers shared the same characteristics, as some economists once assumed.[162] In the real world, however, the "average" or aggregate characteristics of retailers and consumers mask wide underlying variations between different

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[161]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 523 ("How easy it is for an inefficient manager to dissipate the differentials on which profitability rests and that it is possible, with the same technical facilities, to produce with a great variety of costs are among commonplaces of business experience that do not seem to be equally familiar in the study of the economist."); Hayek, *Meaning of Competition*, at 101-102 ("In conditions of real life the position even of any two producers is hardly ever the same. . . . at any given moment the equipment of a particular firm is always largely determined by historical accident, and the problem is that it should make the best use of the given equipment (including the acquired capacities of the members of its staff) and not what it should do if it were given infinite time to adjust itself to constant conditions."); *id.* at 97 (explaining that "competition is in a large measure competition for reputation"). *Cf.* Langlois, *Transaction Costs, Production Costs, and the Passage of Time*, at 2-4 (explaining how neoclassical price theory rested on assumption that the market "was full of identical firms, possessing identical production technologies"); CARL KAYSEN AND DONALD F. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS, 9 (1959) (assuming that "[l]arge permanent differences in economic efficiency among firms . . . are either nonexistent or rare.").

[162]*See* n. ____, *supra* and accompanying text (explaining that price theory assumed that all firms in a particular industry shared the same production function).

members of the dealer or consumer class.[163] Thus, a "one size fits all" approach would ensure an improper mix of promotional efforts by every non-average dealer or every average dealer serving non-average consumers.[164] It might even defeat the purpose of relying upon dealers, who possess knowledge about local conditions, in the first place.[165] A planner that hoped to achieve anything like optimal results would want to determine the nature of these differences and account for them when determining what sort of promotion each dealer should produce.[166]

This account of the shortcomings of central planning helps illuminate similar problems with a manufacturer's efforts to plan the promotional activities of its employees. To be sure, the manufacturer's owners would hold a residual claim, *i.e.*, a property right, to the fruits of the firm's efforts and therefore have greater incentives than state planners to "get things right," particularly in a competitive market.[167] Nonetheless, such owners would not engage in promotion themselves, but

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[163]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524.

[164]*See id.* at 524.

[165]*See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 110 (suggesting that automobile manufacturers rely upon independent dealers to distribute their products because dealers possess information about local conditions not readily available to manufacturers).

[166]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524 ("The sort of knowledge with which I have been concerned [*i.e.*, which is necessary for central planning] is knowledge of the kind which by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form. The statistics which such a central authority would have to use would have to be arrived at precisely by abstracting from minor differences between things, by lumping together, as resources of one kind, items which differ as regards location, quality, and other particulars, in a way which may be very significant for the specific decision. It follows from this that central planning based on statistical information by its nature cannot take direct account of these circumstances of time and place, and that the central planner will have to find some way or other in which the decisions depending on them can be left to "'the man on the spot'").

[167]*See generally* N. SCOTT ARNOLD, THE PHILOSOPHY AND ECONOMICS OF MARKET SOCIALISM: A CRITICAL STUDY (1994); Louis De Alessi, *Property Rights, Transaction Costs, and*

would instead have to rely upon employees to do so. While such employees would have access to localized knowledge, they would, unlike owners, have no right to the fruit of their efforts and would thus lack the necessary incentives to gather and exploit such knowledge properly.[168] Given the absence of employee property rights, a manufacturer that desired optimal results would have to direct employees' promotional activities.[169] In order to generate such directions, these owners would still have to inform themselves about actual and potential consumers as well as the capacities of each of its employees. Having gathered this information, the owner would have to process it and determine the promotional duties of each employee-dealer, just like a state central planner.

X-Efficiency: An Essay In Economic Theory, 73 AMER. ECON. REV. 64, 68 (1983) (because ownership in public enterprises is not transferable, managers of such enterprises are subject to less effective monitoring); G. Warren Nutter, *Markets Without Property: A Grand Illusion*, 217, 222-23, in THE ECONOMICS OF PROPERTY RIGHTS (E. Furubotn & S. Pejovich, eds 1974) (same).

[168] *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 161 (transferring activity from the market to a firm dampens incentives to innovate, because employees do not realize the full benefits of their efforts).

[169] *Cf.* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AMER. ECON. REV. 777, 782-83, 794 (1972) (private firms empower residual claimants to direct economic activity so as to ensure that decisionmaker possesses appropriate incentives).

Of course, a vertically-integrated manufacturer could employ incentive-based compensation mechanisms instead of simple wage contracts. Employees working pursuant to such arrangements would pursue owners' interest more vigorously than would those working pursuant to wage contracts. *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 146-47. Still, such arrangements would only lead to optimal promotional decisions if they conferred on employees the entire residual product attributable to the employees' efforts thus rendering them "owners" of the items in question. The best way to achieve this result, of course, would be to sell the products in question to dealers, who would thereby internalize the complete benefits of their own efforts.

At the same time, the manufacturer would have to respond to constant changes in the various data described earlier.[170] The sources of this change would be varied. Entry or other initiatives by competing manufacturers or dealers could change consumer tastes or reveal tastes that were previously hidden.[171] Moreover, marginal consumers could switch to other products, thus revealing a new set of marginal consumers. These marginal consumers, in turn, could have different tastes and preferences; they could also be susceptible to different promotional strategies. Such entry could also reveal new and more effective promotional strategies.[172] Employees could acquire new capabilities, either individually or in the aggregate. Individual regions could experience an influx or outflux of consumers, and exogenous factors, like changes in the media market, could alter the relative costs of various forms of promotion.

A firm's owners could rely upon the entity's employee-dealers to acquire and report relevant information about promotional options. But, then, so could a central planner.[173] Indeed, like the planner, who could impose legal obligations on its "citizen-employees" to gather and report such

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[170] *Cf.* Hayek, *Meaning Of Competition*, at 101 ("all economic problems are created by unforeseen changes that require adaptation"); Hayek, *The Use of Knowledge In Society*, 35 AMER. ECON. REV. at 524 ("The economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place.").

[171] *See* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 123-39 (examining role of entry in changing or revealing consumer preferences).

[172] *See* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 107-122.

[173] *See* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 115 (recounting dictum by Lenin that, in a Communist state, the whole economy "would be run as one big factory.").

knowledge, a firm could impose contractual obligations on its employees to do the same.[174] Still, the imposition of such obligations would simply create another problem: the need to monitor compliance with them. Such monitoring would not be possible without some method of gathering information about employee performance. Perhaps a firm could rely on other employees to engage in such monitoring. But, then, who would monitor the monitors?[175]

Similar shortcomings would likely beset a manufacturer's attempt to engage in "vertical" planning of the promotional decisions of its "independent" dealers as envisioned by the two benign approaches described earlier.[176] Such a strategy would replace one sort of form contract — the firm — with another — a dealership arrangement.[177] As the residual claimant of the firm's activities, the owner would possess the requisite incentives to "get things right."[178] On the other hand, this owner would lack the knowledge possessed by local dealers. Such planning would require the owner to gather, process and disseminate the same knowledge as a central planner. While theoretically possible in a world where the cost of generating such knowledge is negligible, in the real world any attempt to plan dealers' promotional activities in this manner would involve significant costs. The

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[174]*See* Scott E. Masten, *A Legal Basis For The Firm*, 4 J. L. ECON. & ORG. 181, 186 (1988) (explaining that employees are legally obligated to convey material information to employers).

[175]*Cf.* Juvenal, Satires VI, 347-48 ("SED QUIS CUSTODIET IPSOS CUSTODES?" or "But who would guard the guardians themselves?").

[176]*See* nn. ____, *supra* and accompanying text.

[177]*See* Masten, *Legal Basis For The Firm*, 4 J. L. ECON. & ORG. at *passim* (explaining that "the firm" is simply a standard set of default obligations enforced by the state); Cheung, *Contractual Nature Of The Firm*, 26 J. L. & ECON. at 5 (explaining that the firm is simply one type of contract).

[178]*See* Alchian & Demsetz, *Production, Information Costs, and Economic Organization*, 62 AMER. ECON. REV. at 782-83, 794.

exact same difficulties, of course, would beset a joint venture's effort to plan the promotional efforts of members who distribute its products.

B. The Property Alternative

Given the high costs of planning, be it by government or a private manufacturer, how else might society allocate resources so as to maximize welfare? Put more precisely, how might society create a system or process that generates and then utilizes knowledge in a manner that maximizes the return from society's existing resources?[179] The conventional answer, of course, is to establish a price mechanism.[180] Such a system, it is said, allows for the decentralized production and utilization of information by the person "on the spot," that is, the individual most likely to possess the knowledge that society wishes to consider when making allocational decisions.[181] Indeed, for some, the "market," *i.e.*, reliance on the price mechanism, is the very antithesis of planning, be it by firms or governments.[182]

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[179]*See* F.A. Hayek, *Competition as Discovery Procedure*, in F.A. HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS, AND THE HISTORY OF IDEAS (1982); Hayek, *Meaning of Competition*, at 95 (a society that hopes to maximize its welfare must ask "what institutional arrangements are necessary in order that the unknown persons who have knowledge specially suited to a particular task are more likely to be attracted to the task[?]").

[180]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at *passim*.

[181]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524-25 (price system ensures that society utilizes information held by "the man on the spot").

[182]*See* Coase, *Nature of the Firm*, 4 ECONOMICA at *passim* (contrasting the "firm" and "the market" and equating the former with planning and the latter with "reliance on the price mechanism"). *See also* Cheung, *Contractual Nature of the Firm*, 26 J. L. & ECON. at 10 (utilization of "the firm" entails reliance upon the "visible hand" of planning in contrast with the "invisible hand" of the market).

Still, an injunction to rely upon "the price system" is a bit vague. Such a system cannot exist in the abstract; it instead depends upon a variety of institutions, most notably, private property and contract.[183] By creating and enforcing such rights, and allowing individuals to trade or alter them, the state creates the institutional framework that makes the price system — the market — possible.[184] Moreover, by creating such a system, the state avoids the necessity of determining how to allocate billions of bits of divisible property and labor on a daily basis in an ever-changing world.[185]

In a system where property rights are well-specified, and individual owners decide how to direct "their" labor and resources, they do so fully cognizant of the costs and benefits of action.[186]

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[183]*See* ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 11-13 (explaining that price-theoretic perfect competition model depends upon perfect specification of property rights and costless transacting); Nutter, *Markets Without Property: A Grand Illusion*, at *passim*; Harold Demsetz, *The Exchange and Enforcement of Property Rights*, 7 J. L. & ECON. 11, 16-19 (1964); *id*. at 18 ("The institution of private property . . . is probably due in part to its great practicality in revealing social values upon which to base solutions to scarcity problems."); Hayek, *Meaning Of Competition*, at 110-11 ("That a functioning market presupposes not only prevention of violence and fraud but the protection of certain rights, such as property, and the enforcement of contracts, is always taken for granted."); *id*. at 112-14. *See also* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 717-18 ("The rights which individuals possess, with their duties and privileges, will be, to a large extent, what the law determines. As a result, the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it.").

[184]*See* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 718 ("It is obviously desirable that [legal] rights should be assigned to those who can use them most productively and with incentives that lead them to do so and that, to discover (and maintain) such a distribution of rights, the costs of their transference should be low, through clarity in the law and by making the legal requirements for such transfers less onerous."). *See also* Armen A. Alchian and Harold Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. 16, 20-22 (1973) (utility of property rights depends upon deregulation of prices and elimination of other restraints on alienation).

[185]*See* Alchian and Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. at 18-20 (contrasting incentive effects of private and communal rights).

[186]*See* De Alessi, *Property Rights, Transaction Costs, and X-Efficiency*, 73 AMER. ECON. REV. at 66 ("If transaction costs are zero, then these rights will be fully defined, fully allocated, and fully enforced. Moreover, they will be reallocated to their highest-valued use regardless of their

Such individual direction, of course, often entails cooperation with others, who consent to the use of their own property and labor.[187] This cooperation, in turn, often requires contractual modification of state-created rights, or the creation of entirely new rights not contemplated by the state.[188] So, for instance, the owner of a trademark has the right to exclude all others from use of its mark, even if others can show that their products are indistinguishable from those of the mark's owner.[189] Still, the trademark's owner can relinquish its rights by contract, licensing the mark to innumerable business partners while at the same time placing strict controls on each licensee's activities.[190] In this way the owner "redefines" the right so as to expand access to "its" product, while at the same time retaining ultimate control over the mark and the image associated with it.

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initial assignment."); Alchian and Demsetz, *Property Right Paradigm*, 33 J. ECON. HIST. at 19-20; Harold Demsetz, *Toward A Theory Of Property Rights*, 57 AMER. ECON. REV. 347, 348-39 (1967) (explaining how well-defined property rights can cause property holders to internalize social costs and benefits of their actions). *See generally* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

[187]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS at 33-54 (analyzing different contractual forms that parties employ to redefine property rights and facilitate cooperation).

[188]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 14 ("contracts that use the state's assistance to delineate and reassign ownership are central to the property rights approach"); *id*. at 33 ("At the heart of the study of property rights lies the study of contracts. Contracts, whether formal or informal, reallocate rights among contracting parties."); Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 718 (background rules can maximize value of production if they allow parties to transfer and redefine property and other rights). *See also* LIBECAP, CONTRACTING FOR PROPERTY RIGHTS, at 29-30 (explaining how California miners created and enforced property rights in gold-rich land nominally owned by the national government).

[189]RESTATEMENT OF THE LAW (THIRD): UNFAIR COMPETITION, § 20(1)(b).

[190]This, of course, is the definition of so-called business format franchising. *See* Kabir C. Sen, *The Use of Initial Fees and Royalties in Business-Format Franchising*, 14 MANAGERIAL & DECISION ECON. 175 (1993) (defining this form of franchising). *See also* Paul H. Rubin, *The Theory of The Firm and the Structure of the Franchise Contract*, 21 J. L. & ECON. 223 (1978).

This is not to say that owners of property have perfect knowledge about the various possible uses of their property. They do not. Nonetheless, in a system that recognizes private property and allows parties to part with such property for a price, there is no requirement that any individual possess more than a fraction of the knowledge that a planner would need to order economic activity.[191] Take the example of a landowner, attempting to decide how to dispose of some farmland. Under a system of central planning, the state would have to decide how that property could be used, and how consumers would value each potential use. Hence, the planner would have to determine the nature of the soil, local weather conditions, and what crops or livestock the land would support. The planner would also have to determine what inputs (*e.g.*, fertilizer, pesticides, machinery, labor, and water) would be necessary for each possible use, as well as the capabilities of potential tenants. Given this knowledge the planner would have to assign some value to various crops or livestock and then determine which potential produce of the land in question was most valuable, net of the cost attributable to each possible use.[192] If, by contrast, land is private property and subject to alienation, the owner of such property — who has every incentive to maximize the land's sale price — would

[191]*See* Hayek, *Use of Knowledge In Society*, 35 AMER. ECON. REV. at 525-26 (explaining that, in a market system, "the whole [of society] acts as one market, not because any of its members survey the whole field, but because their limited fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all.").

[192]Similarly, a government that "owned" the airwaves could decide who gets to broadcast on which frequency, based on a prediction regarding what, exactly, the person would broadcast, how much it would cost to do so, and whether such a broadcast would maximize the welfare of listeners, net of the costs of producing the broadcasts in question. *See* Ronald H. Coase, *The Federal Communications Commission*, 1 J. L. & ECON. 1 (1959).

have to make one simple and straightforward determination: who is willing to pay the most for the property.[193]

Of course, the fact that the landowner in our example does not have to obtain and employ certain knowledge does not mean that no one has to. Someone, after all, has to decide how much to offer the owner for his land, and the owner presumably will choose from among many such competing offers. So, for instance, a farmer that hopes to grow beans on the land in question will have to determine the cost of such cultivation, as well as the value of the beans he plans to produce. A rancher who proposes to raise cattle would make a similar determination. In composing their bids, each potential owner would, of course, possess the incentives necessary to produce a bid that reflected the best assessment of the land's value in each particular use. Each individual would rely upon localized and idiosyncratic knowledge about its own capabilities as well as the costs and (net) benefits of utilizing the property in question. Such knowledge would exceed the practical reach of a central planner.[194]

In short, even the free market and the system of private property that supports it require the generation and dissemination of a vast amount of knowledge. Still, a property system essentially delegates this task to a myriad number of individual actors, each with incentives to maximize the value of its property, and each responding to and acting upon signals produced by other property

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[193]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 526. *See also* Demsetz, *Exchange and Enforcement of Property Rights*, 7 J. L. & ECON. at 17 (discussing crucial link between property and the price system's allocative function).

[194]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524-25.

owners.[195] The result, of course, is a decentralized "market" system for producing, disseminating and using knowledge, a system that will generally outperform central planning.[196]

C. Property Rights And Intrabrand Restraints

As explained earlier, both benign accounts of intrabrand restraints begin with the unexplained assumption that a manufacturer has decided to rely upon the market to distribute its goods. By contrast, the comparison of central planning, on the one hand, and a price system supported by property rights on the other, helps illuminate a manufacturer's decision to rely upon dealers as well as the rationale for intrabrand restraints. If property rights and reliance on the price mechanism are an antidote to the shortcomings of central planning, then perhaps such rights might be superior to a regime in which manufacturers "plan" the activities of employees through explicit expectations regarding promotional activities.[197] By creating such rights and allocating them among independent dealers, a society could avoid and delegate the task of deciding how, exactly, to exploit the property in question. At the same time, society could ensure that the individuals most likely to have access to the knowledge necessary to make the correct promotional decisions will have the incentives to gather and employ such knowledge.

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[195]Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524-28.

[196]*See* Nutter, *Markets Without Property*, at 220-24; F. A. Hayek, *The New Confusion About "Planning," in* F. A. HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS, 179 (1978) (planning is inferior to market alternatives); Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 527-28 (contending that no one has devised a workable alternative to the price system for allocating resources in a society premised on the division of labor).

[197]*See* nn. ____, *supra* and accompanying text (describing this option and its various potential shortcomings).

Positive law creates just such a system of property rights. Absent a collateral agreement, dealers and others who purchase products from a manufacturer possess title and thus control over such items.[198] With such control, dealers are free to exclude potential customers from "their" products unless consumers pay an agreed price for the product in question. Under positive law, then, manufacturers that do not wish to plan the promotional activities of employee-dealers may opt in to a regime of property rights under which dealers — who are "on the spot" — are free to decide how to promote the product, as well as where, to whom, or at what price to sell it.[199] Moreover, as true owners of the product, that is, as claimants to the item's residual value, dealers would appear to have appropriate incentives to maximize the net benefits from sales of the product, thus acting as perfect agents of the manufacturer.[200] Dealers who exercise these rights wisely, that is, choose the right mix of promotional activities, will "capture" the most customers, and realize the highest prices.[201] Put another way, each dealer will "keep what it kills."[202] In contrast, employees of a vertically-integrated manufacturer, who possess no such property right, would possess highly imperfect incentives to

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[198] *See* Uniform Commercial Code § 2-106(1) ("sale" of a good involves "passing of title from the seller to the buyer for a price."); *see also* § 2-403 (a "purchaser of goods acquires all title which his transferor had").

[199] *See Arnold, Schwinn & Co.*, 388 U.S. at 377-78 (describing common law's hostility to restraints on alienation of personal property).

[200] *See* Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (agents will faithfully pursue principals' interests if they internalize full costs and benefits of their actions).

[201] *See*, *e.g.*, SULLIVAN, ANTITRUST, at 414-15 (arguing that "the market," that is, unbridled rivalry between dealers, will produce correct investments in promotion).

[202] *Cf.* Pierson v. Post, 3 Caines 175 (N. Y. 1805).

acquire the knowledge necessary to engage in appropriate forms of promotion.[203] By relying upon independent dealers, then, a manufacturer can harness the high-powered incentives produced by the market and thus avoid the shortcomings inherent in a system of complete integration or other methods of "planning" dealer promotional activities.[204] A joint venture can realize similar benefits by declining to distribute its output and instead relying upon its members to do so.[205] Each approach would reflect the prediction by some economists that parties will allocate property rights to the party most able to affect the property's value.[206]

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[203]*See* Williamson, *Law Economics And Organization*, at 14-15 (describing various shortcomings of complete integration, including low powered incentives, administrative controls, and relative inability to adapt to change). *See also* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 8-9, 52-53 (efficiency requires parties to allocate property right to party whose efforts will have the largest impact on the property's value).

Similar considerations are said to explain a firm's decision to rely upon a franchising system. For instance, an entrepreneur with an idea for a new restaurant chain could open hundreds of restaurants, owning each restaurant himself or herself and employing everyone who works there. Under such an approach, employee-managers would make the day-to-day operating decisions at each particular restaurant. While such employees would have access to information about the tastes and preferences of local consumers, for instance, they would not internalize the revenue (or costs) of the operation they supervised. By adopting a franchise system, on the other hand, the entrepreneur could ensure that the operator of each restaurant — an independent franchisee — would internalize at least a large share of the costs and benefits of the business. *See* Brickley, *Incentive Conflicts And Contractual Restraints: Evidence From Franchising*, 42 J. L. & ECON. at 748 (contending that franchising serves this purpose).

[204]*See* Williamson, *Law, Economics, And Organization*, at 14-15 (describing various shortcomings of complete integration, including low powered incentives, administrative controls, and relative inability to adapt to change); Cheung, *Contractual Nature of the Firm*, 26 J. L. & ECON. at 10-13 (explaining how piece rate and market systems "clearly reveal productivity differentials among workers" and thus eliminate the need for extensive monitoring).

[205]*See, e.g., TOPCO*, 405 U.S. at *passim* (evaluating restraint ancillary to venture where members distributed venture product).

[206]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 8-9, 52-53, 78.

Decentralization is not an end in itself, however: it is useful only to the extent that it leaves market participants with appropriate incentives to produce valuable social goods.[207] To be sure, economists once assumed that "the market" would automatically produce an optimal allocation of resources, ignoring, as they did, the prospect of opportunism and the cost of producing and transferring information.[208] In the real world, however, reliance on the market often comes with a cost — what economists refer to as a "transaction cost."[209] A market based upon a rule of capture may in reality leave dealers with highly imperfect property rights and thus attenuate the benefits of a decentralized system for identifying promotional strategies. Take, for instance, the case of an automobile manufacturer that sells its cars to all approved dealers without any accompanying contractual restraint on dealer prices or territories. The result, of course, would be a rule of capture: each dealer could "keep" whatever customer it convinced to purchase a car from it. The problems with such a rule should be clear, in light of prospect of dealer opportunism that Professor Telser identified. Most importantly, the efforts of one dealer may well lead to the "capture" of a customer by a different dealer. So, for instance, one dealer might advertise a particular automobile, spend significant time explaining the car's attributes, and allow a consumer to test drive it. Having decided

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[207]*See* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 718 (opining that a well-functioning economic system requires that "rights should be assigned to those who can use them most productively *and with incentives that lead them to do so*.") (emphasis added). *See generally*, Demsetz, *Toward A Theory Of Property Rights*, 57 AMER. ECON. REV. at 356-58 (decentralized land holdings may result in externalities that parties can sometimes control by contract).

[208]*See* nn. ____, *supra* and accompanying text (outlining the tendency of price-theorists to assume away opportunism and information costs).

[209]*See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 20-22; Coase, *Nature Of The Firm*, 4 ECONOMICA at 390.

that it wants the car in question, the consumer could then walk across the street and purchase the vehicle from a "cut rate" dealer who provides few, if any, promotional services.[210]

Of course, a rule of capture does not itself prevent a full service dealer from selling the automobile in question. Having provided the consumer with requisite information about the product, the dealer could simply match or undercut the price charged by the cut-rate dealer. Indeed, such a strategy would be rational, insofar as the cost of advertising and demonstrating the car is sunk and thus should not enter into the dealer's calculus when it decides on the car's sale price.[211] While rational in the short run, such a strategy would leave the dealer with a loss. More importantly, when deciding whether to promote a different car in the future, the putative full service dealer would have to consider the possibility that it will not be able to realize a price sufficient to cover the cost of the automobile and its promotion. As a result, information regarding the attributes of the product would remain a collective good — once produced, recipients at least could consume the good without paying for it.[212] The result, of course, will be less promotion, and thus fewer customers, in the first

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[210]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91-92.

[211]*Cf.* FRANK H. EASTERBROOK AND DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 187-190 (1991) (explaining how production of information can be a sunk cost in the context of a bidder's search for an undervalued target).

[212]*See* OLSEN, COLLECTIVE ACTION, at 14-15 (defining collective good in this manner). *See also* n. ___, *supra*.

place.[213] Similar problems beset the rule of capture in other contexts where property rights are poorly specified.[214]

It would therefore seem that reliance upon the price system buttressed by property rights would entail significant transaction costs, given that promotional information is a collective good. Knowing that promotional investments are vulnerable to opportunistic free riding, dealers would have no incentive to discover optimal promotional strategies. As a result, reliance on a market-based system of distribution would not generate the sort of localized knowledge that could facilitate distribution of the manufacturer's product. Similar problems would beset a joint venture's reliance on individual members to distribute the venture's product.[215]

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[213]*See* Telser, *Fair Trade*, 3 J. L. & ECON. at 91-92. *See also, e.g.*, Isaksen v. Vermont Castings, Inc., 825 F.2d 1158, 1161-62 (7th Cir. 1987) (reporting dealer letter to manufacturer stating that "[t]he worst disappointment is spending a great deal of time with a customer only to lose him . . . because of price. This letter was precipitated by the loss of 3 sales of V.C. stoves today to people whom we educated and spent long hours with.").

[214]*See Pierson*, 3 Caines at 180 (Livingston, J., dissenting) ("Hence it follows, that our decision should have in view the greatest possible encouragement to the destruction of an animal, so cunning and ruthless in his career. But who would keep a pack of hounds; or what gentleman, at the sound of the horn, and at the peep of day, would mount his steed, and, for hours together, '*sub jove frigido*,' or a vertical sun, pursue the windings of this wily quadruped, if, just as night came on, and his strategems and strength were nearly exhausted, a saucy intruder, who had not shared in the honor or labor of the chase, were permitted to come in at death and bear away in triumph the object of pursuit?"); Dhammika Dharmapala and Rohan Pitchford, *An Economic Analysis of Riding To Hounds: Pierson v. Post Revisited*, 18 J. L. ECON. & ORG. 39 (2002) (arguing that rule of capture announced in Pierson v. Post results in underinvestment in foxhunting); EASTERBROOK and FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, at 172-74 (arguing that rule of capture for corporate takeovers would undermine incentives for bidders to seek out undervalued companies and thus result in suboptimal investment in information).

[215]*See, e.g.*, United States v. TOPCO Assoc., 319 F. Supp. 1031, 1040 (N.D. Ill. 1970), *rev.'d*, 405 U.S. 596 (1972) (finding that joint venture's reliance on unrestrainted members to distribute its product would result in suboptimal promotion).

Still, goods are not "collective" or "private" in the abstract. Instead, their status as such is a function of property rights.[216] Thus, by altering the background structure of such rights, the state can render private what might otherwise be a public or collective good.[217] Moreover, not all property can be found in positive law; some is a creature of private contract, which actors use to rearrange rights the law has granted.[218] Indeed, no system of law could precisely define and enforce each and every sort of property right that society might usefully employ; thus, society allows individuals to create or redefine such rights by contract.[219] By rearranging these rights, private actors can alter the institutional structure of production and thus affect the ultimate allocation of resources.[220]

A classic example of a contractually-created property right is the covenant ancillary to the sale of a business. According to positive law, the seller of a business has every right to compete with

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[216]Ronald H. Coase, *The Lighthouse In Economics*, 17 J. L. & ECON. 357 (1974) (a good's status as "public" or "private" depends upon the background definition and assignment of property rights). *See also* Alchian and Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. at 22-25 (system of property rights can transform a communal good characterized by underproduction into a private good).

[217]*See* Coase, *The Lighthouse In Economics*, 17 J. L. & ECON. at *passim*.

[218]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 14.

[219]*See* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 718 (allowing individuals to alter and transfer rights by contract will maximize social output). *Cf.* Hayek, *Socialist Calculation*, at 135 ("The recognition of the principle of private property does not by any means necessarily imply that the particular delimitation of the contents of this right as determined by the existing laws are the most appropriate.").

[220]*See* Coase, *Institutional Structure Of Production*, 82 AMER. ECON. REV. at 716 (explaining that economic actors adopt practices, including contracts, that minimize the cost of transacting and thus affect the allocation of resources); Williamson, *Law, Economics, And Organization*, at 26 (distinguishing between institutional environment, or "rules of the game," created by the State, and the institutions of governance, or "play of the game," which parties can alter by contract).

the purchaser immediately after the transaction of sale. That is to say, purchasers have no state-created right to particular customers or particular prices for the goods or services they provide.[221]

The absence of such state-created rights does not reflect a social determination that such rights are useless or counterproductive. Instead, by failing to create such rights, the state avoids the cost of determining the proper scope of these covenants, thus forcing the affected parties to set the relevant boundaries.[222] Predictably, then, parties often create such rights by contract. More precisely, sellers of a business often agree not to compete with the purchaser in a defined area for a fixed period of time after the sale.[223] Courts regularly enforce such agreements, recognizing as they do that these undertakings are necessary to create and protect the value of the business and associated goodwill that the seller has created.[224] To be sure, such restrictions reduce competitive rivalry;

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[221]So, for instance, there is no common law tort of competition. *See* RESTATEMENT OF THE LAW (THIRD): UNFAIR COMPETITION, § 1, COMMENT a ("The freedom to compete necessarily contemplates the probability of harm to the commercial relations of other participants in the market. . . . The freedom to compete implies a right to induce prospective customers to do business with the actor rather than the actor's competitors."). *But compare* MICHAEL TREBILCOCK, THE COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS, 235-35 (1986) (discussing Commonwealth precedents holding that sellers may not specifically solicit former customers, but may nonetheless serve them in the ordinary course of business).

[222]*See* Ian Ayers & Robert Gertner, *Filling Gaps In Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989) (default rules that penalize both parties for not memoralizing their understanding force parties to bargain explicitly over issue in question).

[223]*See*, *e.g.*, Diamond Match Co. v. Roeber, 13 N.E. 419 (N.Y. 1887) (enforcing such a restraint). *See also* United States v. Addyston Pipe and Steel Co., 85 F. 271, 280-82 (6th Cir. 1898) (examining the common law governing such restraints).

[224]*See*, *e.g.*, *Addyston Pipe*, 85 F. at 280 ("It was of importance, as an incentive to industry and honest dealing in trade, that, after a man had built up a business with an extensive good will, he should be able to sell his business and goodwill to the best advantage, and he could not do so unless he could bind himself to an enforceable contract not to engage in the same business in such a way as to prevent injury to that which he was about to sell."); *Diamond Match Co.*, 13 N.E. at 421 ("It is an encouragement to industry and to enterprise in building up a trade, that a man shall be allowed

nonetheless, such a reduction is necessary to protect incentives to create and sell businesses in the first place.[225] These contracts, then, help construct the "free market" and affect the allocation of resources within it.[226]

In a similar way, a manufacturer that chooses to rely upon "the market" to distribute its goods need not content itself with the atomistic process implied by the rule of capture. "The market" is not an exogenous or natural entity, entirely distinct from the firms or individuals that employ it. To the contrary, "the market" can entail any number of institutional arrangements.[227] Thus, while positive law grants dealers a presumptive right to full dominion and control over products they purchase, the

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to sell the goodwill of the business and the fruits of his industry upon the best terms he can obtain.").

[225] *See* National Society of Professional Engineers v. United States, 435 U.S. 679, 688-89 (1978) ("The long term benefit of enhancing the marketability of the business itself — and thereby providing an incentive to develop such an enterprise — outweighed the temporary and limited loss of competition."); *see also* TREBILCOCK, RESTRAINT OF TRADE, at 252-53 ("A restrictive covenant enables the owner of a business in effect to capitalize the benefits of expected returns from investment in goodwill, for example, trade secrets, specialized know-how, or customer connections, in the sale price of a business by creating limited property rights in these assets in the purchaser that protect him from reappropriation of those assets by the vendor."). *See also id.* at 258-66 (arguing that enforcement of such restrictions is generally in the public interest).

[226] *See generally* Coase, *Institutional Structure of Production*, 82 AMER. ECON. REV. at 717-18 (market outcomes and resulting allocation of resources depend upon background legal rules).

In a similar way, courts occasionally hold that the covenant of good faith implied in all contracts protects dealers' expectations to serve particular areas unmolested by rivalry from the manufacturer or newly-appointed dealers. *See* Vylene Enterprises, Inc. v. Naugles, Inc., 90 F.3d 1472, 1477 (9th Cir. 1996) (implied covenant of good faith prevented franchisor from awarding new franchise in close proximity to franchisee); Scheck v. Burger King Corp., 798 F.Supp. 692, 694-700 (S.D. Fla. 1992); Photovest Corp. v. Fotomat Corp., 606 F.2d 704, 727-28 (7th Cir. 1979) (implied covenant of good faith prevented franchisor from opening several company-owned stores near franchisee's location).

[227] Ronald H. Coase, *Nature of the Firm: Meaning*, 4 J. L. ECON. & ORG. 19, 19 (1988) (noting that there are various contractual arrangements between "the firm" and "the market"); Cheung, *Contractual Nature of the Firm*, 26 J. L. & ECON. at 19 (same).

parties can alter these rights by contract, creating what appear to be new rights in the process. So, for instance, a manufacturer might decide to condition the sale of its product on dealers' agreement not to deal with certain customers. It could do so expressly, by reserving certain customers to itself or other dealers.[228] Or, it could do so indirectly, by limiting the dealers' locations or obtaining an agreement from dealers not to sell purchased products outside a certain defined area.[229] Finally, the manufacturer could set a price below which dealers could not charge and enforce such a floor against price cutters.[230] Similar logic can explain intrabrand restraints that are horizontal, as when a joint venture imposes such restraints on members who distribute its products.[231]

Each of these vertical intrabrand restraints can be viewed as a method of creating and defining new property rights, more precisely, rights to exploit customers that a dealer or other distributor has "found." By redefining property rights in this way, manufacturers can reduce the cost of relying upon the market and, ironically, more closely replicate the results produced by the "perfect" market that economists once took for granted.[232] One method does so expressly. Others

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[228]*See* White Motor Co. v. United States, 372 U.S. 253 (1964) (evaluating arrangement that reserved certain customers to the manufacturer while at the same time granting dealers exclusive territories).

[229]*See Sylvania*, 433 U.S. at *passim* (evaluating arrangement limiting locations from which franchisee could distribute manufacturer's product).

[230]*See* Monsanto Co. v. Spray-Rite Service Co., 465 U.S. 752 (1984) (affirming jury finding that manufacturer imposed minimum rpm on its dealers).

[231]*See TOPCO*, 405 U.S. at *passim* (evaluating horizontal territorial restraints ancillary to a joint venture); United States v. Sealy, Inc., 388 U.S. 350 (1967) (evaluating horizontal price restraint ancillary to joint venture).

[232]*See* Ronald H. Coase, *Industrial Organization: A Proposal for Research*, 68 in R. H. COASE, THE FIRM, THE MARKET AND THE LAW (1988) (arguing that non-standard contracts and other practices are often "a necessary element in bringing about a competitive situation");

— like exclusive territories and location clauses — rely upon realities of time and space to raise the probability that dealers will receive the patronage of the customers that they convince to purchase the manufacturer's product. Finally, a price floor ensures that dealers who produce information useful to consumers need not lose those customers to dealers who refuse to incur the cost of promotion. Just as a mandatory price *ceiling* would prevent dealers from recouping their investments in ancillary goods, so too would unbridled rivalry drive prices so low that dealers could not recoup their investments in information.[233] By attenuating such rivalry, then, a price floor can protect these investments, thus perfecting dealers' incentives to identify and pursue optimal

WILLIAMSON, ECONOMIC INSTITUTIONS, at 27 (suggesting that non-standard contracts can be methods of redescribing property rights so as to ensure that those who have control over an asset's use internalize the benefits of their efforts). *See also* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 11-13 (explaining that price theory's model of perfect competition, which assumed away information and bargaining costs, rested on assumption that property rights are perfectly specified).

[233] *See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 28-29 (explaining that ceilings on the price of gasoline prevented dealers from charging gasoline prices that covered the cost of related services such as service attendants).

promotional strategies.[234] In the same way, of course, similar horizontal restraints can grant property rights to members of a joint venture that distribute the venture's product.[235]

None of these mechanisms results in a perfect specification of property rights in consumers or, more importantly, information. A dealer that can only sell from a single location can nonetheless sell to any customer in the world that arrives there.[236] Moreover, a price floor cannot prevent consumers from purchasing from free-riding dealers; it can only make them indifferent about doing

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[234]Professor Williamson has previously suggested that "nonstandard" contracts can be means of "redescribing property rights" so as to place control over assets "in the hands of those who can use those rights most productively." *See* WILLIAMSON, ECONOMIC INSTITUTIONS at 27. He does not, however, mention the property rights approach in connection with intrabrand restraints. Indeed, in prior work, he indicated that intrabrand restraints would accompany obligations to provide particular collateral services, including advertising. *See* Williamson, *Assessing Vertical Market Restrictions*, 127 U. PENN. L. REV. at 976. Moreover, Judge Bork has previously suggested that minimum rpm can be seen as the equivalent of a contractual property right. Responding to a claim that promotional information does not constitute "output" for the purpose of social welfare calculus, Bork noted that "[c]ontract law delegates to private persons the power to create property rights because of their superior knowledge of the efficiencies to be gained in particular situations. RPM is best viewed as an instance of this general principle." *See* Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L. J. 950, 956 (1968). Bork did not elaborate on this suggestion, but instead returned to his argument that promotion is a form of socially useful output. *See id.* at 956-58. Moreover, Bork's subsequent writings on the subject do not repeat the "property rights" characterization or otherwise shed light on the Telser/Klein-Murphy debate. *See, e.g.*, BORK, ANTITRUST PARADOX, at 280-99, 449-50, 453-54. Finally, in the introduction to an article on exclusive dealing, Professor Marvel suggests that minimum rpm can be viewed as a property right held by dealers. *See* Howard P. Marvel, *Exclusive Dealing*, 25 J. L. & Econ. 1, 2 (1982). He does not, however, examine the basis for the creation and enforcement of such a right, choosing instead to examine the rationale of exclusive dealing. *See id.* at *passim*. Indeed, Professor Marvel suggests that manufacturers grant exclusive territories to "selected full service dealers," a conclusion inconsistent with the argument made in this paper. *See id.* at 10.

[235]*See, e.g.*, *TOPCO*, 405 U.S. at *passim*.

[236]*See generally* Murrow Furniture Galleries, Inc. v. Thomasville Furniture Industries, Inc., 889 F.2d 524 (4th Cir. 1989) (evaluating manufacturer policy preventing dealers from advertising outside the state and selling to customers not physically present in the store).

so. Finally, dealers can cheat on such a floor by, for instance, bundling discounted items with the main product.[237]

Still, the absence of perfection is no argument against a property rights interpretation of intrabrand restraints. In the real world no property right is perfectly specified — each definition leaves some room for opportunistic exploitation by others.[238] Moreover, manufacturers can take various steps to minimize such behavior.[239] An imperfect property right is often better than no property right at all, and manufacturers presumably choose among various imperfect mechanisms. By defining and enforcing property rights in this way, manufacturers transform the information produced by those who distribute their products from a collective good into a good that is largely private in nature, thus insuring that someone internalizes the benefits of its production.[240] Because they internalize these benefits — as well as the costs of promotion — dealers can act as faithful

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[237]*See* nn. ____, *supra* and accompanying text.

[238]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 11 ("Because of the costliness of delineating and policing rights, opportunities arise for some people to capture what appears to be others' wealth."); *id*. at 92-93 (employing free salt and pepper provided by restaurants as examples of imperfectly-specified property rights which could result in overconsumption of these items); Demsetz, *Exchange and Enforcement of Property Rights*, 7 J. L & ECON. at 14-15 (discussing examples of parking spaces).

[239]*See* nn. ____, *infra* and accompanying text (outlining various means that manufacturers may employ to minimize dealer attempts to cheat on such restraints).

[240]*See* Ronald H. Coase, *The Lighthouse In Economics*, 17 J. L. & ECON. 357 (1974) (a good's status as "public" or "private" depends upon the background definition and assignment of property rights); I. Trotter Hardy, *Not So Different: Tangible, Intangible, and Analog Works and Their Comparison For Copyright Purposes*, 26 U. Dayton L. Rev. 211 (2001) (intellectual property's status as a collective or private good depends upon background rules of property).

agents of the manufacturer, identifying and producing the type and amount of promotion that the manufacturer would desire.[241]

Once in possession of such a right, a dealer would itself determine how best to exploit the right in question, given its own unique knowledge, capabilities, and assessment of the preferences of local consumers.[242] Thus, one automobile dealer might rely heavily on print advertising. Another might emphasize the recruitment and retention of highly trained sales people. A third might invest in a courteous and efficient service department, hoping that consumers' experience with the department will encourage them to return to the dealer when they purchase a new vehicle.[243] A fourth might seek an equal balance of all three methods. In an economy and society as varied as ours, each dealer would likely choose to produce a slightly different mix of promotional information, knowing, of course, that it could reap the rewards of such investments.[244] Moreover, no dealer's choice would be "set in stone," as the localized knowledge driving such decisions would be in

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[241]*See* Jensen & Meckling, *Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. at *passim* (agent who internalizes the costs and benefits of actions will faithfully pursue owner's interests); *see also* Bork, *Price Fixing and Market Division*, 75 YALE L. J. at 436 (contending without elaboration that exclusive territories can create an "identity of interest" between the manufacturer and its dealers).

[242]*See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. REV. at 193 (pointing out that exclusive territories allow different dealers to direct different forms of promotion at different customer bases).

[243]*See* Kevin Arquit, *Resale Price Maintenance: Consumer Friend or Foe*, 60 ANTITRUST L. J. 447, 453 (1991) (explaining that minimum rpm can induce dealers to supply after-market services).

[244]Indeed, one scholar sympathetic to Professor Telser's analysis has noted that manufacturers might prefer different promotional strategies in, say, rural areas than in cities. *See* Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 110-11 & n. 84. This scholar assumed, however, that manufacturers would "combine vertical restrictions with enforcement to elicit various forms of intensive retailing effort from their dealers." *Id.* at 110.

constant flux.[245] Reliance on such a market system of distribution would allow for more rapid and nuanced responses to these changes and thus lower the cost of distribution.[246]

Intrabrand restraints, then, can alter the institutional framework within which dealers conduct business.[247] Such restraints redefine dealer property rights in a manner that minimizes the transaction costs associated with relying upon a market system of distribution.[248] These restraints need not be part of a manufacturer's efforts to "plan" the promotional activities of its dealers, as the two benign approaches assume.[249] As explained earlier, such planning would be extremely expensive; no manufacturer could gather the knowledge required to announce and enforce promotional obligations unique to each particular dealer.[250] Thus, such restraints facilitate the manufacturer's decision *to reject* such planning in favor of a market-based system of distribution, with its high-powered

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[245] *See* nn. ____, *supra* and accompanying text (explaining that data relevant to promotional decisions are constantly changing).

[246] *See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 523-24. *See also* Cheung, *Contractual Nature Of The Firm*, 26 J. L. & ECON. at 13-15 (reliance on market to allocate resources entails less direction by those purchasing goods or services).

[247] *See* Coase, *Institutional Structure Of Production*, 82 AMER. ECON. REV. at 716 (explaining that many business practices are designed to lower the cost of relying upon the market to conduct economic activity).

[248] *See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 11 ("Exchange partners may impose restrictions on one another in order to reduce the level of undesired behavior. Consequently, property rights — particularly the right to consume what appears to be one's property — are often made subject to [contractual] constraint."); *id.* at 14 (explaining that many property rights are defined by contract).

[249] *See* nn. ____, *supra* and accompanying text (explaining how approaches offered by Professors Telser, Klein and Murphy all rest on assumption that manufacturers plan or expect particular promotional services from their dealers).

[250] *See* nn. ____, *supra* and accompanying text.

incentives and reliance on local knowledge. In the same way, of course, horizontal intrabrand restraints can facilitate a joint venture's decision to rely upon its members to sell the venture's output. Within such a property rights regime, each dealer or venture member will decide individually how much to invest in promotion, what sort of promotion to employ, and how to respond to any changes in relevant variables.

To be sure, a single manufacturer or joint venture that is vertically-integrated into distribution would also possess a "property right" in any information it produced about its products. As a nominal matter, such a firm would be the "sole owner" of the information it produced.[251] Those who embrace a price-theoretic approach to industrial organization might assume that this single owner would adopt optimal promotional strategies.[252] Still, contrary to the assumptions of price theory, the "firm" is not a "black box," whose employees automatically pursue the exact interests of its owners.[253] In the modern manufacturing corporation or joint venture, the residual claimants who actually internalize such benefits will be far removed from the local context in which promotional decisions are best made. The individuals "on the spot," however, will be employees,

[251]*See* Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J. L. & ECON. 553 (1993).

[252]*See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 608-610 (contending that complete vertical integration would insure that the manufacturer internalized benefits of promotion and thus overcome free rider problem). *See also* nn. ____, *supra* and accompanying text (noting price-theoretic assumption that firms always pursued unitary interest).

[253]*See* MACHOVEC, PERFECT COMPETITION AND THE TRANSFORMATION OF ECONOMICS, at 16 (describing the firm of price theory as a roboticized calculating machine); Langlois, *Contract, Competition and Efficiency*, 55 BROOKLYN L. REV. at 837 ("Since the [price-theoretic] firm is a single, indivisible unit, the traditional theory describing the classical firm ignores the firm's contractual make-up."). *Cf.* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 608 (embracing price theoretic assumption that integrated firm will produce amount and type of promotion desired by the owners).

and thus lack the high-powered incentives possessed by independent entrepreneurs.[254] By adopting intrabrand restraints and relying upon "the market" to distribute it goods, the manufacturer or joint venture can have the best of both worlds: decentralized decisionmaking by individuals with access to local knowledge *and* appropriate incentives to provide effective promotion.[255]

Such restraints naturally reduce "competition," but then so do other property rights, be they created by the state or contract. That is the point of property and contract. The law of trademark, for instance, assigns a seller an exclusive right to sell products under its brand, thus eliminating competition with others who might try to sell under the same mark without the owner's consent.[256] Similarly, contracts ancillary to the sale of a business eliminate competition between the seller and purchaser.[257] Nonetheless, courts enforce such restraints, so long as they are "reasonable," because they facilitate the creation of property in the first place.[258]

III. Implications

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[254]*See* Williamson, *Law, Economics, And Organizations*, at 14-15 (explaining that employees lack the high-intensity incentives possessed by entrepreneurs); Cheung, *Contractual Nature Of The Firm*, 26 J. L. & ECON. at 10, 13-15 (explaining that, unlike wage contracts, piece work arrangements directly reward productivity differences between laborers).

[255]*See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. REV. at 193 (suggesting that vertical restraints can facilitate decentralization of promotional decisions); Bork, *Price Fixing and Market Division*, 75 YALE L. J. at 468 (*semble*).

[256]*See* n. ____, *supra*.

[257]*See* nn. ____, *supra* and accompanying text.

[258]*See* Broadcast Music, Inc. v. Columbia Broadcast System, 441 U.S. 1, 18-19 (1979) (courts should be reluctant to condemn restraints that are reasonably necessary to further intellectual property rights). *See also* Fred S. McChesney, *Antitrust and Intellectual Property: First Principles*, 2000 U. CHI. LEGAL F. 23, 25-27 (same).

As explained earlier, most scholars believe that intrabrand restraints are presumptively beneficial. These scholars generally embrace Professor Telser's analysis and claim that such restraints can prevent dealers or others who distribute products from free riding on each others' promotional efforts. Nonetheless, some scholars still cling to the inhospitality tradition, rejecting the claim by Telser and others that such restraints usually reduce the cost of distribution and thus promote social welfare. At the same time, Professors Klein and Murphy have questioned Telser's account of these restraints and offered their own "performance bond" theory of such arrangements. Finally, while courts presume that some such restraints are beneficial, others are automatically unlawful or presumptively so. As shown below, the property rights account of intrabrand restraints offered here amends Telser's account and thus bolsters it against both sets of critiques. A property account also compells rejection of antitrust doctrines hostile to some such restraints, doctrines still left over from the inhospitality tradition.

A. Response To Critics Of The Special Services Argument

The property rights approach to intrabrand restraints offers a more robust response to several critiques of Professor Telser's account and thus undermines any lingering manifestations of the inhospitality tradition. Take, for instance, the claim that intrabrand restraints constitute inappropriate manufacturer "administration" of dealers' promotional decisions.[259] To be sure, Telser's articulation of the "special services" rationale for intrabrand restraints would seem to rest upon a claim that manufacturers know what types of promotional services dealers should produce, as well as the prices they should charge or locations where they should sell. Similarly, the Klein and Murphy "performance bond" argument depends quite explicitly on a claim that manufacturers determine what

[259] *See* nn. ____, *supra* and accompanying text.

sorts of services dealers should provide and then terminate those dealers who do not provide them. By contrast, a property rights approach to intrabrand restraints rejects any assumption — explicit or not — that manufacturers "plan" or "administer" dealer activities. Indeed, the whole point of a property rights approach is that manufacturers understand that they are *incapable* of administering dealers' promotional decisions.

It may well be true that dealers are in a better position than manufacturers to determine what sorts of promotion to produce, given their access to localized knowledge about the costs and benefits of various forms of promotion. Yet, that is precisely the point of a property rights interpretation of intrabrand restraints. By creating and defining property rights, such restraints avoid the pitfalls of centralized decisionmaking while at the same time fully harnessing the benefits of decentralization. A contrary approach — one that relied on the pure rule of capture — would undermine the very enterprise of decentralization by distorting the incentives faced by dealers who seek to determine (independently) how, exactly, to promote the product they have purchased.

Viewed as a property right, then, intrabrand restraints are the very antithesis of manufacturer planning. To be sure, such rights eliminate certain forms of rivalry between dealers. For instance, an exclusive territory prevents a dealer outside the territory from securing the patronage of customers that the dealer within the territory has cultivated. In this sense, such a restraint might be said to "plan" a dealer's decisions about where to compete with other dealers of the same brand. However, this attribute does not distinguish intrabrand restraints from other forms of property, whether created by the state or contract. All property, after all, prevents some individuals from enjoying the fruits

of others' efforts. That is the point of property.[260] The alternative — a war of all against all for whatever resources individuals can capture — would replicate the "tragedy of the commons" throughout society.[261] Market-based competition requires property, including property that parties

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[260]*See* BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS, at 10-11 (where property rights are imperfectly specified, some individuals will be able to capture the fruits of others' efforts); Demsetz, *Toward A Theory Of Property Rights*, 57 AMER. ECON. REV. at *passim* (contending that society recognizes property rights when such rights are necessary to ensure that individuals reap the rewards of their own efforts, as against the depredations of interlopers).

[261]*See* Alchian and Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. at 19-20 (explaining shortcomings of communal ownership system). *See also* Northern Securities Co. v. United States, 193 U.S. 197, 411 (1903) (Holmes, J., dissenting) ("I am happy to know that only a minority of my brethren adopt an interpretation of the law that would make eternal the bellum omnium contra omnes and disintegrate society so far as it could into individual atoms. If this were [Congress'] intent I should regard calling such a law a regulation of commerce a mere pretense. It would be an attempt to reconstruct society."). *See also* Frank H. Easterbrook, *Vertical Restraints and the Rule of Reason*, 53 ANTITRUST L. J. 135, 156 (1984) ("Every restricted dealing arrangement is designed to influence price. It must be. If territorial limits induce dealers to supply additional service and information, they do so only because they raise the price and call forth competition in the service dimension. . . . Every argument about restricted dealing implies that the restrictions influence price. There is no such thing as a free lunch; the manufacturer can't get the dealer to do more without increasing the dealer's margin.").

create by contract.[262] Recognition of such property, including property created by contract, does not constitute improper "administration" in any economically meaningful sense.

A property rights interpretation of intrabrand restraints also accounts for the absence of explicit or implicit obligations that such restraints merely "support." As explained earlier, some scholars and jurists consider the absence of such obligations damning to a manufacturer's claim that an intrabrand restraint enhances the efficiency of its system of distribution.[263] This critique emphasizes the failure of Professor Telser and others to articulate just how, exactly, intrabrand restraints induce dealers to engage in the promotional activities "desired by the manufacturer."[264] Indeed, for some, the absence of such an explanation suggests that intrabrand restraints do not, in

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[262] *See* Coase, *The Firm, The Market, And The Law*, at 8-9 (explaining that commodity exchanges, often invoked as exemplars of perfect competition, are in fact the result of complex contracts that restrain the discretion of numerous actors); Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 1 (1984) (same). *See also* Hayek, *Competition as Discovery Procedure*, at 190 (protection of private property and "the whole aggregate of libertarian institutions of law" is necessary to support a price system); Hayek, *Meaning Of Competition*, at 110-111 (competitive market presupposes background rules of property, contract, and tort).

Courts have long recognized that contracts are not suspect merely because they eliminate rivalry that would otherwise have occured. *See, e.g.*, *National Society of Professional Engineers*, 435 U.S. at 687-88 (enforcement of commercial contracts, including covenants not to compete, "enables competitive markets — indeed a competitive economy — to function"); Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918) (Brandeis, J.) ("But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.").

[263] *See* nn. ___, *supra*, and accompanying text. *See also Business Electronics Corp.*, 485 U.S. at 739-42 (Stevens, J. dissenting) (contending that intrabrand restraint must be "ancillary" to some express obligation to provide promotional services to avoid *per se* condemnation); Carstensen, *Distribution Restraints*, 69 ANTITRUST L.J. at 591.

[264] *See* nn. ____, *supra* and accompanying text.

fact, produce the benefits that Telser attributes to them.[265] Far from suggesting anything nefarious, however, the absence of such explicit obligations is entirely consistent with a property rights conception of these restraints. The whole point of a property right, after all, is to facilitate the delegation of economic authority to the firm or individual with the best access to the knowledge necessary to make the decision.[266] Such delegation *avoids* the need for detailed prescription of dealers' promotional duties, thereby ensuring that dealers can pursue promotional strategies that further the manufacturer's interest. Indeed, the imposition of such precise obligations, by contract or otherwise, is the very antithesis of the sort of property right posited here.[267] The absence of explicit or implicit obligations collateral to an intrabrand restraint tells us nothing about the social value of such restraints.

Finally, a property rights conception of intrabrand restraints undermines the claim that various "less restrictive alternatives" are valid substitutes for such arrangements. Take, for instance,

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[265]*See* nn. ____, *supra* and accompanying text.

[266]*See* nn. ____, *supra* and accompanying text.

[267]The Supreme Court seems to have been groping in this direction in *Business Electronics Corp*. There the dissent argued that the absence of promotional obligations undertaken by dealers required a conclusion that an agreement to terminate a price cutter was not collateral to a legitimate purpose and thus was a "naked" restraint of trade in *per se* violation of the Sherman Act. *See Business Electronics Corp.*, 485 U.S. at 739-42 (Stevens, J. dissenting). The majority responded by noting that a restraint could be "ancillary" to a transaction of sale despite the absence of any other contractual obligations. *See id.* at 729, n. 3. The majority also pointed out that a requirement that manufacturers adopt explicit obligations to avoid *per se* treatment was perverse, as such restraints may be "inefficient" when compared to "efficient nonprice vertical restraints." *See id.* Unfortunately, the Court did not explain how such a restraint could be "efficient" absent some mechanism for ensuring that the remaining dealer in fact performs the promotional services desired by the manufacturer. This paper supplies the argumentation missing from the Court's opinion, recognizing, as it does, that such an agreement could effectively assign weak property rights to the remaining dealer.

the claim that manufacturers can simply bargain with dealers and thus negotiate precise promotional obligations.[268] As already explained, bargaining, policing and enforcing such obligations would be costly — perhaps more costly than implementing a resale price or exclusive territory, for instance.[269] Yet, even if such bargaining and enforcement were costless, such an alternative would be inferior to the contractual specification of a property right. After all, the whole point of a property right is that the manufacturer *does not know* what sorts of information dealers should be producing or, for that matter, how much. Without such knowledge, a manufacturer could not bargain with dealers over their promotional obligations. As a result, a requirement that a manufacturer further its interests by imposing discrete promotional obligations on dealers would rest upon a mischaracterization of the (legitimate) interest served by the restraint.[270] Put another way, explicit bargaining over dealers' precise promotional obligations simply cannot further the interest advanced by contractual property rights, namely, the creation of a decentralized process for producing and acting upon knowledge regarding optimal promotional investments. Those who would rely on such bargaining incorrectly

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[268] *See* nn. ____, *supra* and accompanying text. *See e.g.*, Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION at 29.

[269] *See* nn. ____, *supra* and accompanying text.

[270] *See* Meese, *Price Theory and Vertical Restraints*, 45 UCLA L. Rev. at 193 (concluding that exclusive territory is superior to manufacturer imposition of particular service obligation because the former approach allows for "dealer-by-dealer decisionmaking about the appropriate mix of various pre-sale and post-sale services").

assume the existence of the very knowledge that intrabrand restraints are designed to produce.[271] Similar considerations apply to other purported contractual alternatives.[272]

Moreover, complete integration is a poor substitute for contractually-created property rights. Such integration eliminates many of the advantages of relying upon the market to distribute

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[271]*See* Hayek, *Meaning of Competition*, at 92-99 (contending that price-theoretic economists assumed the widespread existence of knowledge and other conditions without asking how the conditions came about).

[272]For instance, so-called "areas of primary responsibility" allow dealers to operate wherever they wish so long as they make "best efforts" within the territory assigned to them. *See* Turner, *Definition of Agreement Under the Sherman Act*, 75 HARV. L. REV. at 699 (defining area of primary responsibility). Even if bargaining over such a provision were costless, such an agreement simply cannot advance the same interest as, say, an exclusive territory, for two independent reasons. First, because such an approach leaves dealers free to sell wherever they wish, no dealer will have any assurance that it will be able to recapture the benefits of promotional investments that it makes in its area of primary responsibility. *See* Meese, *Quick Look*, 68 ANTITRUST L. J. at 487, n. 109. Second, a contractual requirement that dealers make their "best efforts" within their area of responsibility simply does not serve the same interest — decentralization — as a contractual property right. Someone, after all, has to determine whether, in fact, a dealer *has* made its best efforts; no manufacturer or court can make such a determination without performing the very same function that contractual property rights delegate to dealers.

Nearly four decades ago, then–Professor Bork hit on a similar response to the claim that areas of primary responsibility will produce the same efficiencies as an exclusive territory. As Bork pointed out, such an alternative would require the manufacturer to constantly supervise and evaluate the promotional activities of each dealer, a task he termed prohibitively expensive in light of dealers' superior access to information. *See* Bork, *Price Fixing And Market Division*, 75 YALE L.J. at 468. While Bork's response to this critique implicitly rested upon the sort of "property rights" logic employed in this paper, he did not employ that term or seek to generalize the concept as an affirmative rationale for reliance upon the market or use of intrabrand restraints. Indeed, Bork treated the promotion produced by completely integrated firms as a perfect baseline for evaluating the promotional efforts of firms that instead rely upon the market. *See, e.g.*, *id.* at 434-35. This assumption would seem to preclude the possibility that reliance on the market is a superior method of distribution. Moreover, he did not employ such reasoning to respond to the "planning" assumptions inherent in the work of Telser, or the subsequent work of Klein and Murphy. In a subsequent article, Bork did suggest, in passing, that vertical restraints could be characterized as contracts for property rights. *See* n. ____, *supra*. He did not, however, elaborate on this suggestion. *See id.* The author is not aware of any subsequent work that elaborates on Bork's suggestion.

products.[273] For instance, by owning its own dealerships and planning the activities of those who work there, a manufacturer would forfeit the benefits of relying upon independent dealers with high powered incentives to develop promotional strategies that serve the best interests of both parties.[274] By defining and conferring property rights on independent dealers, then, intrabrand restraints help manufacturers realize the best of both worlds: independent dealers willing and able to behave in an entrepreneurial fashion and appropriate incentives to ensure that these dealers internalize the full benefits of their activities.[275]

In summary, a property rights account of intrabrand restraints helps explain how such contracts induce dealers or other firms to identify and execute promotional strategies that further the interest of a single manufacturer or joint venture in generating demand for its product. At the same time, such an approach rebuts any claim that "less restrictive alternatives" can serve the same objectives as these restraints. These conclusions have concrete implications for antitrust policy. For example, the realization entirely undermines the theoretical claim that such restraints are

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[273]*Cf.* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 381 (1937).

[274]*See* Williamson, *Law, Economics and Organization*, at 14-15, 21 (explaining that, by transforming independent contractors into employees, complete integration dampens the incentive of employees and creates opportunities for shirking not present in the marketplace).

[275]One scholar has suggested that intrabrand restraints are less effective than complete integration because they are susceptible of cheating and difficult to enforce. *See* Carstensen, *Distribution Restraints*, 69 ANTITRUST L. J. at 606-608. As a result, this scholar concludes that such restraints are most likely anticompetitive attempts to exercise or create market power. *See id.* at *passim*.

If such restraints are, in fact, difficult to enforce, it is not clear how they can be anticompetitive in any significant way. At any rate, a firm is itself a nexus of (voluntary) contracts, and complete integration does not magically transform independent dealers into automatons who single-mindedly pursue the owner's will. Thus, complete integration will not insure the optimal production of promotion. *See* nn. ____, *supra* and accompanying text.

presumptively anticompetitive.[276] As a result, the property rights account would compell the rejection of all existing *per se* rules against intrabrand restraints, be they vertical or horizontal, thereby requiring the Supreme Court to repudiate numerous precedents associated with the inhospitality tradition.[277] That is to say, a property rights approach suggests that courts should analyze all intrabrand restraints under the Rule of Reason currently reserved only for some.[278]

A property account also has important implications for the Rule of Reason analysis that courts apply to such restraints. For one thing, a property rights account undermines any claim that certain restraints are so often anticompetitive that their mere existence should suffice to establish a *prima facie* case.[279] While an intrabrand restraint may, in some instances, be anticompetitive, proof

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[276]*See* nn. ____, *supra* and accompanying text.

[277]In particular, application of a property rights account would require the Court to overrule: *Monsanto*, 465 U.S. at 761 n. 7 (adhering to *per se* rule against minimum rpm); *Maricopa Medical Society*, 457 U.S. at *passim* (declaring maximum horizontal price fixing ancillary to a legitimate joint venture unlawful *per se*); *TOPCO*, 405 U.S. at *passim* (declaring horizontal allocation of territories ancillary to legitimate joint venture unlawful *per se*); and *Sealy*, 388 U.S. at *passim* (declaring horizontal minimum price fixing ancillary to legitimate joint venture unlawful *per se*).

[278]*See* nn. ____, *supra* and accompanying text (explaining that courts analyze some intrabrand restraints under the Rule of Reason while treating others as unlawful *per se*).

[279]*See* nn. ____, *supra* and accompanying text (noting precedents taking such an approach in Rule of Reason litigation). *See also* California Dental Ass'n v. F.T.C., 526 U.S. 756, 769-70 (1999) (mere existence of horizontal restraint on price or output suffices to establish a *prima facie* case). *See also NCAA*, 468 U.S. at 110 (same); Department of Justice and Federal Trade Commission Competitor Collaboration Guidelines, § 3.3 (presuming explicit restraint on price or output unlawful). It should be noted that one court of appeals has already applied lenient Rule of Reason analysis to horizontal intrabrand restraints, rejecting an automatic presumption that such restraints are anticompetitive whenever they invoke price or output. *See* Chicago Professional Sports Ltd. Partnership v. N.B.A., 95 F.3d 593 (7th Cir. 1996) (lenient Rule of Reason applies when restraint accompanies substantial integration between the parties). *But see* HOVENKAMP, FEDERAL ANTITRUST POLICY, at 189 (dubbing this decision "controversial"). This decision did not invoke the "property rights" logic applied here, however.

that parties have entered such an agreement is at least equally consistent with a procompetitive interpretation and thus cannot give rise to a presumption against it.[280]

A property rights account also undermines the case for analyzing such alternatives on a case-by-case basis whenever a plaintiff makes out a *prima facie* case and adduces a less restrictive alternative.[281] After all, such case-by-case analysis rests on the assumption that such alternatives can, in some instances, produce the same or similar benefits as the intrabrand restraint under challenge.[282] As just shown, however, such alternatives can never produce one benefit of decentralization, namely, the delegation of decisionmaking power to the person "on the spot."[283] Therefore, if a manufacturer can show that an intrabrand restraint in fact functions as a contractually-created property right, Rule of Reason analysis should end, regardless of whether the plaintiff can adduce a less restrictive alternative.

B. Bolstering The Telser Approach Against The Klein and Murphy Account

A property rights account of intrabrand restraints also helps amend and therefore buttress Professor Telser's original argument against objections put forth by Professors Klein and Murphy.

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[280]*See* Matsushita Elec. Indus. Corp. v. Zenith Radio Corp., 475 U.S. 574, 587-95 (1986) (noting that evidence that is as consistent with procompetitive as with anticompetitive objectives cannot, without more, support an inference of anticompetitive conduct); Monsanto Co. v. Spray-Rite, 465 U.S. 752, 761-64 (1984) (same); First Nat'l Bank v. Cities Serv. Co., 391 U.S. 253, 279-80 (1968) (same). *See also* Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451, 466-67 (1992) ("Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law.").

[281]*See* nn. ____, *supra* and accompanying text (explaining that, under current law, a plaintiff will prevail if it shows that the defendant could achieve its objectives via a means less restrictive of competition).

[282]*See* nn. ____, *supra* and accompanying text.

[283]*See* Hayek, *Use Of Knowledge In Society*, 35 AMER. ECON. REV. at 524.

As explained earlier, Telser did not explain how an intrabrand restraint can ensure that dealers produce the exact promotional services desired by the manufacturer.[284] This omission led Klein and Murphy to question whether such restraints can themselves induce dealers to engage in such promotion. Absent any explanation in the work of Telser, these scholars surmised a different role for such restraints, namely, as performance bonds. The property rights account offered here provides a response to the Klein and Murphy challenge.

As an initial matter, a property rights perspective helps illuminate a manufacturer's decision to rely upon the market to distribute its products in the first place. Like price theorists, however, Professors Telser, Klein, and Murphy simply ignore this question and begin with the unexplained assumption that the manufacturer has (exogenously) chosen to rely upon the market. By ignoring the rationale for this decision, these scholars have obscured the rationale for intrabrand restraints.[285]

In contrast, a property rights perspective helps explain why manufacturers choose to rely upon the market in the first place. Moreover, this explanation helps rebut the claim that such

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[284] *See* nn. ____, *supra* and accompanying text.

[285] *Cf.* THOMAS KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTION, 114-17 (1970) (relaxation of background assumptions can lead to new explanations for previously–observed phenomena).

I do not mean to suggest that Professors Telser, Klein and Murphy embrace all of the postulates of price theory. Quite the contrary, these scholars have offered creative approaches that depart in numerous ways from the price-theoretic framework. Both accounts, for instance, depend upon the assumption that dealers are prone to opportunism. Both also assume that manufacturers cannot control this behavior with explicit contracting. Nonetheless, it would appear that these scholars have retained at least one habit of price theory, namely, the assumption that the boundaries of the firm, here the manufacturer, are a given, determined by considerations exogenous to the rationale for intrabrand restraints. As a result, it is suggested, these scholars have overlooked a powerful rationale for reliance on the market, and thus intrabrand restraints, namely, decentralization.

arrangements cannot induce the exact promotional services "desired by the manufacturer."[286] Instead, by relying upon the market, manufacturers consciously leave the decision regarding promotional investments to independent dealers, who have a comparative advantage in acquiring the sort of knowledge necessary to make wise promotional decisions.[287] To be precise, a property rights approach suggests that reliance on the market presents two main advantages: one informational and one incentive based. By relying upon local dealers, manufacturers can decentralize decisionmaking authority to the individuals most likely to possess the knowledge necessary to make optimal decisions regarding promotion and distribution of the manufacturer's product.[288] At the same time, by relying upon dealers who are independent, manufacturers ensure that those who are "on the spot" have high-powered incentive to seek and employ the proper promotional strategy.[289] In turn, intrabrand restraints can help manufacturers perfect the incentives of dealers, and thus enhance the benefits of a market-based, decentralized system of distribution. The lack of any mechanisms to assure that dealers produce particular services actually enhances the value of such property rights, by ensuring that dealers can rely upon their own local knowledge to pursue strategies that serve the

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[286] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 265-67. *See also* Klein, *Distribution Restrictions*, 7 S. CT. ECON. REV. at 7, n. 11.

[287] *See* nn. ____, *supra* and accompanying text. *See also* David Butz & Andrew Kleit, *Lessons From Interstate Circuit*, 44 J. L. & ECON. 145-46, 155 (2001) (arguing that intrabrand restraints could enhance promotional expenditures by selected retailers, without inducing promotion by others).

[288] *See* nn. ____, *supra* and accompanying text.

[289] *See* nn. ____, *supra* and accompanying text.

manufacturer's interest.[290] Similar logic, of course, can explain why a joint venture would rely upon members bound by horizontal intrabrand restraints to distribute its product.[291]

Given its account of the rationale for reliance on the market, a property rights approach rejects the basic assumption that manufacturers desire or anticipate particular types or levels of promotion as well as the claim by Professors Klein and Murphy that there is an implicit contract between manufacturers and dealers that implements the manufacturer's expectations regarding such services. Indeed, a property rights approach would posit that manufacturers deliberately choose *not* to determine what sorts of promotion dealers should produce. Such a determination would simply be too expensive, as it would require manufacturers to gather unique, localized information about each dealer and its base of actual and potential consumers. While such an approach would make sense in a world once imagined by price theorists, it would be prohibitively expensive in the real world.[292] Like those who argue that bargaining over promotional obligations is a "less restrictive means" of furthering the manufacturer's objective, Klein and Murphy assume the very knowledge that intrabrand restraints are designed to create.[293]

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[290]For instance, a property rights account explains how intrabrand restraints are "self-monitoring," as one scholar has suggested without elaboration. *See* Marvel, *Resale Price Maintenance Controversy*, 63 ANTITRUST L. J. at 64. It also explains *why* manufacturers would want such restraints to be "self-monitoring." *See also* nn. ____, *supra* and accompanying text.

[291]*See* nn. ____, *supra* and accompanying text.

[292]*Cf.* nn. ____, *supra* and accompanying text (explaining how price theory's model of perfect competition helped support calls for central planning).

[293]*See* Hayek, *Meaning of Competition*, at 92-99 (explaining how price theorists assumed existence of knowledge and other conditions without inquiring into what type of economic system brought them about); nn. ____, *supra* and accompanying text.

To be sure, dealers can "cheat" on intrabrand restraints, as Klein and Murphy have claimed. For instance, a dealer can sell outside a territory assigned to it, so long as it can avoid detection. Similarly, a dealer can seek to avoid minimum rpm by engaging in non-promotional competition, *e.g.*, by providing disguised discounts to consumers.[294] Customers aware of such cheating can thus consume the promotion produced by full service dealers and still obtain the product at what is effectively a discount price.

Still, the fact that a property right is susceptible of some cheating does not itself condemn the interpretation offered here. In the real world, all property rights are imperfect, *i.e.*, subject to some cheating. The seller of a business can "cheat" on the plain meaning of a covenant not to compete by locating right outside the radius set by the arrangement and serving customers from within that radius. A neighbor can cheat on a fee simple by walking her dog very early in the morning, evading detection when the animal trespasses. Finally, a driver can park in a lot marked "for customers only" without patronizing the store that owns the lot. While imperfect, each of the rights just mentioned serves the interests of the parties asserting them.

At any rate, property owners can take some steps to minimize the prospect of cheating. For instance, the purchaser of a business can also secure a promise from the seller not to solicit certain customers, or even customers in a certain area. A property owner can put a fence around her yard or get up early to monitor potential interlopers. Finally, a merchant can charge for parking and provide free parking to those who validate their tickets.

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[294]*See Klein and Murphy*, 31 J. L. & ECON. at 266. *See also* nn. ___, *supra* and accompanying text (explaining how bundling and other forms of non-price competition can undermine a cartel).

In the same way, manufacturers can take various steps that reduce the imperfections that might otherwise beset intrabrand restraints.[295] For instance, a firm that adopts an exclusive territory can also prevent dealers from soliciting orders from outside the territory.[296] It can even require dealers to decline to serve customers who live outside their assigned territories.[297] Similarly, a manufacturer concerned that dealers might cheat on minimum rpm by discounting related products can prohibit the dealer from selling or advertising such products or, instead, maintain the prices of these products as well.[298] Also, a manufacturer concerned that dealers might offer overly generous warranties can take on the warranty function itself and prohibit its dealers from offering more generous warranties. In this way, a manufacturer can reduce the number of alternative forms of non-price competition available to dealers and thus further perfect the property right that it grants. Joint

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[295] *See* Marvel, *Resale Price Maintenance Controversy*, 63 ANTITRUST L. J. at 64 ("[w]ith a manufacturer supervising its conduct, a dealer will find it difficult to evade RPM."). It should be noted that even Professors Klein and Murphy argue that non-price competition between dealers will not always dissipate the premium created by intrabrand restraints. If it did, then such restraints could not serve as performance bonds! *See* Klein and Murphy, *Vertical Restraints*, 31 J. LAW & ECON. at 278-79.

[296] *See Murrow Furniture*, 889 F.2d at 525-29 (evaluating a provision that prevented dealers from advertising outside area of primary responsibility).

[297] *Cf. Murrow Furniture*, 889 F.2d at 525-29 (evaluating a provision barring dealers from selling to consumers not physically present in the store).

[298] *See* Marvel, *Resale Price Maintenance Controversy*, 63 ANTITRUST L. J. at 64-65 & n.11 (contending that manufacturers can impose advertising restrictions that deter such cheating); THOMAS OVERSTREET, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EVIDENCE 84-101 (1983) (providing examples of such restrictions); Goldberg, *Vertical Restrictions*, 58 TEX. L. REV. at 109-110 (arguing that manufacturers can limit cheating by prohibiting bundled sales). *See also* Illinois Corporate Travel, Inc. v. American Airlines, Inc., 806 F.2d 722 (7th Cir. 1986) (evaluating airline's ban on travel agent's advertisement of discounts of reasonable ticket prices).

ventures, of course, can take similar steps to perfect the property rights they might confer on members that distribute their products.

Nonetheless, the mere fact that contractual property rights *allow* dealers to realize the benefits of optimal promotional strategies by recouping their investments in information does not mean that dealers will, in fact, make such investments. Something must spur them do so. According to Klein and Murphy, dealers who are parties to intrabrand restraints may simply choose to pocket the premium that such restraints create without embarking on any promotional efforts. As a result, they say, manufacturers must adopt some method of contractual control to make sure that dealers in fact invest in the production of information.[299]

In fact, the prospect of such "pocketing" seems more hypothetical than real. Dealers may only "pocket" a premium created by intrabrand restraints if they are able to attract a significant number of customers who are willing to purchase the product at the price necessary to support the premium. While intrabrand restraints may temper intrabrand competition, they have no effect on the rivalry between the restrained dealers and dealers selling other brands.[300] Such *inter*brand competition — including actual or potential competition from completely integrated firms — could deprive shirking dealers of the customers necessary to support a strategy of passively pocketing the premium.[301] Absent cooperation between different manufacturers and their dealers, such competition

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[299] *See* nn. ____, *supra* and accompanying text (explaining Klein and Murphy's views on this question).

[300] *See* Continental T.V. v. G.T.E. Sylvania, 433 U.S. 36, 52 n. 19 (1977) (explaining that extent of interbrand competition is unaffected by restrictions on intrabrand competition).

[301] *See id.* (interbrand competition can discipline a dealer's exercise of intrabrand market power).

will likely spur dealers to exercise their contractually-protected rights to produce information. Dealers who do not produce such information will likely find themselves losing customers to those who do.

Put another way, any claim that manufacturers can grant dealers a "premium" over the price that would otherwise prevail in the market assumes that there are a significant number of consumers willing to pay the premium-creating price. How is it, though, that dealers can be sure that consumers will pay such prices, particularly given competition from other brands? The response that Klein and Murphy provide — product differentiation — is not so much an answer as an unexplained assumption.

Product differentiation — actual differences between functionally similar products — is not a preexisting, exogenous phenomenon but instead the result of a process in which intrabrand restraints play an important role.[302] Even where products are in fact different, someone must communicate these differences to potential consumers.[303] Absent such communication — promotion — consumers will have no reason to prefer the manufacturer's product to the various products sold by the firm's competitors.[304] Thus, Klein and Murphy's claim that dealers might "pocket" a

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[302]*See* Meese, *Price Theory and the Rule of Reason*, 2003 ILL. L. REV. at ____, & n. ____ (explaining that manufacturers would not create differentiated products absent some method for communicating such differences to consumers).

[303]*See* Williamson, *Assessing Vertical Market Restrictions*, 127 U. PENN. L. REV. at 976-77 (where potential customers lack perfect information about attributes of differentiated products manufacturers must communicate product's attributes to consumers). JOHN M. CLARK, COMPETITION AS A DYNAMIC PROCESS, 251 (1961) ("Product differentiation requires substantial selling effort in some form.").

[304]*See* Williamson, *Assessing Vertical Market Restrictions*, 127 U. PENN. L. REV. at 976-77 (where potential customers lack perfect information about attributes of differentiated products, manufacturers or dealers must expend resources promoting such items).

premium produced by an intrabrand restraint is entirely circular, as it assumes the existence of the very promotional activities that intrabrand restraints induce dealers to perform![305] Dealers that hope to create a premium in the face of interbrand competition must engage in pre-sale promotion.

It should be noted that the property rights approach offered here does not *ipso facto* exclude all other explanations for intrabrand restraints. As noted earlier, economists and other scholars sometimes observe intrabrand restraints imposed by manufacturers whose products do not require pre-sale promotional services.[306] Such restraints could reflect attempts by manufacturers or dealers to exercise market power, to the detriment of consumers and society.[307] It may even be the case that such restraints function as performance bonds to facilitate the enforcement of obligations unrelated to pre-sale promotion.[308] So, for instance, a manufacturer might employ such restraints as part of an effort to ensure that dealers properly refrigerate a product, or take other steps necessary to assure

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[305]*Cf.* Hayek, *Meaning of Competition*, at 92-99 (criticizing economists for embracing economic models that assume competitive results without asking what sort of process is necessary to produce those results in the first place); *id*. at 96 (explaining that mainstream economic models assume away the very activities, including activities differentiating products, that constitute useful competition in the real world).

[306]*See* nn. ____, *supra* and accompanying text. *See also* Marvel, *Resale Price Maintenance Controversy*, 63 ANTITRUST L. J. at 80 ("Even with new theories and reinterpretation of existing efficiency explanations, not all uses of RPM are likely to be explicable.").

[307]*See* nn. ____, *supra* and accompanying text.

[308]*See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 277-82 (arguing that manufacturers might employ restraints in this manner).

its quality.[309] In this way a manufacturer could prevent its dealers from providing suboptimal quality to consumers and thereby injuring the manufacturer's reputation.[310]

It is true that the use of intrabrand restraints to protect a product's goodwill may be part of an effort to "plan" certain aspects of dealers' activities. Nonetheless, such planning differs from efforts to plan dealers' *promotional* activities in two different ways. First, almost by definition, manufacturers are in a better position to manage the quality of their product than are individual dealers, who had no role in developing or manufacturing it. Second, there is no obvious property-rights alternative to such centralized management of the product quality in question. While many consumers are repeat players, who will purchase the manufacturer's product dozens of times in a lifetime, nothing requires them to purchase the product from the same dealer more than a fraction of the time. So, for instance, a consumer may purchase a particular brand of beer from two or three local grocery stores, some convenience stores, liquor stores, and restaurants. In such an environment, assigning dealers a "property" right by intrabrand restraint or otherwise will not induce dealers to take those steps that are necessary to protect a product's quality, since dealers with such a right may still not internalize more than a fraction of the benefits of maintaining product quality.[311] In these circumstances some form of planning by the manufacturer of a dealer's activities that maintain product quality may be warranted.

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[309] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. & ECON. at 277-82 (arguing that Coors employed intrabrand restraints in an effort to accomplish this objective).

[310] *See* Klein and Murphy, *Vertical Restraints*, 31 J. L. ECON. at 277-82. *See also* Brickley, *Incentive Conflicts and Contractual Restraints: Evidence From Franchising*, 42 J. L. ECON. at 748-49 (explaining that individual franchisees may lack appropriate incentives to protect quality of franchise product).

[311] *See* n. _____, *infra* and accompanying text.

In the end, then, the Klein and Murphy account of how intrabrand restraints induce promotion desired by a manufacturer or joint venture does not withstand careful analysis. As a result, scholars and courts attempting to discern the rationale of various intrabrand restraints may have to distinguish between the different sorts of transaction costs that reliance upon the market can produce. Where reliance on an unrestrained market will lead to an underinvestment in pre-sale promotion, it seems best to interpret these restraints as contractually-created property rights, without any accompanying controls on dealers' promotional activities. Such restraints induce the optimal production of promotional services, as Professor Telser claimed, without the sort of planning be apparently envisioned. Where, on the other hand, reliance on the market leads to dealer shirking that affects product quality, it may make sense to interpret such restraints as performance bonds.

CONCLUSION

Manufacturers or joint ventures can avoid the costs of planning promotional activities by relying upon the market to distribute their goods. Reliance on the market can come with costs of its own, however, as dealers or other distributors find themselves unable to recoup their investments in promotional activities. Intrabrand restraints can help cure this market failure, by granting effective property rights over information that dealers and others produce. Far from planning the activities of dealers and others, such restraints in fact facilitate the delegation of decisionmaking to independent firms with the knowledge and incentives necessary to develop and execute optimal promotional strategies.