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Basing-Point Pricing Establishes Illegal Vertical Agreements

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BASING-POINT PRICING ESTABLISHES ILLEGAL VERTICAL AGREEMENTS

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I. INTRODUCTION

Basing-point pricing is a system of pricing in which a firm refuses to sell a product FOB and sets a delivered price that includes transportation costs calculated from the same reference point used by other firms in the industry. Used when transport costs are high, this system enables every seller to quote a nearly identical price to any particular customer, regardless of that customer's distance from any particular seller. The costs and benefits of this practice closely resemble the costs and benefits that result from price-fixing. Because the harm from an agreement to fix prices so often exceeds the slight and rare benefit from that agreement, price-fixing is per se illegal. Basing-point pricing similarly causes more harm than benefit and thus would almost uniformly be found unreasonable if tested under the rule of reason.[1] Therefore, any contract or combination that effectuates basing-point pricing should be declared per se illegal under section 1 of the Sherman Act.[2]

Enforcement of antitrust laws against basing-point pricing has, however, been bedeviled by what may be called the "agreement problem."[3] Since members of an industry may adopt basing-point

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[1] Under the rule of reason, monopolies and combinations in restraint of trade are unlawful only if their harms outweigh their benefits. Standard Oil Co. v. United States, 221 U.S. 1, 59-60 (1911). However, "the inquiry is confined to a consideration of impact on competitive conditions." National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 690 (1978).

[2] 15 U.S.C. § 1 (1976). This section provides in relevant part that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." *Id.; cf. infra* notes 67-84 and accompanying text (basing-point pricing is always unreasonable).

[3] For an excellent summary of the history of antitrust attacks on basing-point pricing, see Note, *Conscious Parallelism in the Use of Delivered Pricing Systems: A Modified Per Se*

pricing through conscious parallelism rather than explicit communication on the subject, they can meet an antitrust challenge to the practice by contending that section 1 does not apply absent proof that the defendants "agreed" to adopt a basing-point system. At best, litigation over the existence of a horizontal agreement will involve protracted discovery of intercompany communications, with the likelihood that a trial would require a complex examination of the economics of conscious parallelism.[4] At worst, a pernicious practice will escape antitrust liability.

It has long been thought that the agreement problem could be avoided if the Federal Trade Commission condemned the use of basing-point pricing as an unfair practice under section 5 of the Federal Trade Commission Act.[5] The Commission then would not have to take a position on whether the parallel use of basing-point pricing constitutes an "agreement."[6] Two recent decisions, however, have cast doubt on this approach. In *Boise Cascade Corp. v. FTC*,[7] the Ninth Circuit refused to enforce a Federal Trade Commission order directing individual firms in the southern plywood

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Standard of Review Under the Federal Trade Commission Act, 66 CORNELL L. REV. 1194, 1200-10 (1981).

[4] *See infra* notes 29 & 36-38 and accompanying text.

[5] 15 U.S.C. § 45 (1976 & Supp. V 1981); *see* P. AREEDA, ANTITRUST ANALYSIS ¶ 331(a), at 394 (3d ed. 1981). In addition to bypassing the agreement problem, the use of § 5 to attack devices that facilitate parallel pricing may provide other advantages. Drawing lines between lawful and unlawful activities of oligopolists can be accomplished on a case-by-case basis by the FTC, which is presumably expert in the economics of competition. *Id.* ¶ 574, at 833-34; Note, *supra* note 3, at 1215 n.111. The procedures of the FTC are especially well suited to meet the concern that clear directions be given to oligopolists. Since the FTC's remedy is a cease and desist order issued under 15 U.S.C. § 45(b) (Supp. V 1981), liability under § 5 is possible only if an enforceable order can be written. *See infra* notes 46-49 and accompanying text. Finally, such an order is prospective only so that damages or other sanctions will be awarded only for violation of a directive specifically addressed to the defendant. *But cf.* E.I. duPont de Nemours & Co. v. FTC, 46 ANTITRUST & TRADE REG. REP. (BNA) 347, 352-53 (2d Cir. 1984) (FTC should provide guidelines by which firms can predict when a violation of § 5 may be found).

[6] Methods of competition that do not violate the Sherman Act because no agreement can be shown may nevertheless violate § 5 of the Federal Trade Commission Act. *See* FTC v. Brown Shoe Co., 384 U.S. 316, 322 (1966); Atlantic Ref. Co. v. FTC, 381 U.S. 357, 369 (1965) (dictum); FTC v. Cement Inst., 333 U.S. 683, 693 (1948) (dictum); Luria Bros. & Co. v. FTC, 389 F.2d 847, 859 (3d Cir.), *cert. denied*, 393 U.S. 829 (1968); New Jersey Wood Finishing Co. v. Minnesota Mining & Mfg. Co., 332 F.2d 346, 351-52 (3d Cir. 1964), *aff'd*, 381 U.S. 311 (1965); Grand Union Co. v. FTC, 300 F.2d 92, 95-98 (2d Cir. 1962); *cf.* FTC v. Beech-Nut Packing Co., 257 U.S. 441, 455 (1922) (unilateral activity held to violate § 5).

[7] 637 F.2d 573 (9th Cir. 1980).

industry to cease and desist from the use of basing-point pricing. The court based its holding on the ground that insufficient proof existed of the harmful effects caused by the pricing system.[8] Given the forensic difficulty of proving an adverse effect on prices,[9] *Boise Cascade* significantly diminishes the effectiveness of section 5 as a means to avoid the agreement problem. In the second recent case construing section 5, the Second Circuit has constructed another obstacle to the use of this section to avoid the agreement problem. The court held that section 5 cannot be applied to a noncollusive business practice that causes substantial anticompetitive effects unless the practice is also coercive, predatory, exclusionary, anticompetitive in purpose, or unsupported by a legitimate business reason.[10]

This Article proposes another solution to the agreement problem, a solution that avoids evidentiary complexities and also permits private enforcement of antitrust laws against basing-point pricing. The central premise of this approach is that a basing-point practitioner enters into a vertical agreement every time he sells his product to a customer. A vertical agreement violates section 1 of the Sherman Act if it is unreasonable. One type of vertical agreement, the tying arrangement, is frequently illegal per se. By employing a basing-point pricing system, a producer necessarily refuses to sell FOB to a customer who wishes to provide his own transportation. This practice constitutes a tie: the tied good is the transportation service, and the tying good is the product being sold.[11] As a tie, the practice should be declared illegal per se. Even if not characterized as a tying arrangement, however, the vertical agreement between the seller and purchaser clearly produces harm

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[8] *Id.* at 577-81. For related developments, see *infra* note 45.

[9] *See* Hay, *Oligopoly, Shared Monopoly, and Antitrust Law,* 67 CORNELL L. REV. 439, 475, 477-80 (1982); Note, *supra* note 3, at 1212 nn.95-97. The difficulty is in establishing what prices would have been in the absence of the challenged practice. This difficulty has led to a liberalization of the rules for proving antitrust damages. *See infra* note 148 and accompanying text.

[10] E.I. duPont de Nemours & Co. v. FTC, 46 ANTITRUST & TRADE REG. REP. (BNA) 347, 353 (2d Cir. 1984). The court held alternatively that, even if § 5 could be applied to legitimate, noncollusive business practices that substantially lessen competition, a reduction in competition sufficient to support finding a violation of § 5 had not been shown in the case at hand.

[11] The illegality of tying arrangements under § 1 of the Sherman Act is based on § 3 of the Clayton Act, 15 U.S.C. § 14 (1976). *See, e.g.,* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4387-88 (U.S. Mar. 27, 1984); *infra* note 87.

without significant redeeming virtue and is thus unlawful under the rule of reason.[12]

II. Consciously Parallel Pricing and the Agreement Problem

A. *The Per Se Illegality of Price-Fixing*

To maximize profits a monopolist sets his price above the marginal cost of production and sells less than would be sold if the industry were competitively organized.[13] In an industry with more than one firm, an explicit price-fixing agreement may raise the price above marginal cost and thereby achieve profits for the industry like those of a monopolist. By complying with the agreement not to sell below the cartel price, firms reduce the supply of output to the market. Carrying out a cartel agreement is easier if the participating sellers are few and the product is homogeneous.[14] With price above marginal cost, the ability of the cartel to duplicate the pricing policy of a monopoly is threatened by the temptation of each seller to cut his price a little below the cartel price and thus increase his sales.[15]

Both monopolies and price fixing cause harm through the distortion of resource allocation which results from a price set in excess

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[12] *See infra* notes 138-39 and accompanying text.

[13] *See* P. Areeda, *supra* note 5, ¶ 114, at 13-16; E. Gellhorn, Antitrust Law and Economics in a Nutshell 56-67 (2d ed. 1981); P. Samuelson, Economics 481-98 (9th ed. 1964); F. Scherer, Industrial Market Structure and Economic Performance 14-20 (2d ed. 1980); *see also* Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911) (Sherman Act was motivated by "dread of enhancement of prices").

[14] P. Areeda, *supra* note 5, ¶ 320(b), at 320. For discussions of conditions making price-fixing easier, see R. Posner & F. Easterbrook, Antitrust 336-38 (2d ed. 1981); F. Scherer, *supra* note 13, at 175-76. On the role of basing-point pricing in reducing barriers to conscious parallelism, see *infra* notes 59-66 and accompanying text. Obviously, with fewer sellers, reaching an agreement is easier, and the probability that price-fixing will be detected is lower. *See* F. Scherer, *supra* note 13, at 199-200; *cf.* P. Areeda, *supra* note 5, ¶ 262, at 276 (oligopoly aids conscious parallelism). Again, with heterogeneous products, sellers must reach agreement on a specific price for each product, and an individual seller is more likely to disagree with the others as to the "fair" price for his product. As a result, "the difficulty of coordination undoubtedly does increase more than proportionally with the number of sellers." F. Scherer, *supra* note 13, at 200. By contrast, with a single, identical product, only one price need be set for all sellers. *See infra* note 59 and accompanying text (homogeneity aids conscious parallelism).

[15] P. Areeda, *supra* note 5, ¶ 318(d), at 348-49: F. Scherer, *supra* note 13, at 171-73; G. Stigler, The Organization of Industry 42 (1968).

of marginal cost.[16] In antitrust law, however, monopolies are treated more favorably than cartels. A monopoly may be the result of superior economic performance with benefits outweighing the harm caused by inefficient resource allocation.[17] Indeed, to foster such performance courts applying the rule of reason require proof of wrongful conduct before finding liability under the Sherman Act.[18] Moreover, upon finding a violation courts hesitate to risk the uncertain economic consequences of granting structural relief and breaking up the monopoly.[19] Thus, harm from monopoly pricing may be tolerated simply because it is difficult to frame and enforce an order directing a monopolist to price at reasonable levels.[20] Cartels conversely do not possess the efficient integration of produc-

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[16] *See, e.g.*, 2 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 403(b), at 271 (1978); F. SCHERER, *supra* note 13, at 16-20.

[17] *See, e.g.*, Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). The court commented:

> [A *per se* rule against monopoly] might . . . deprive the leading firm in an industry of the incentive to exert its best efforts. Further success would yield not rewards but legal castigation. The antitrust laws would thus compel the very sloth they were intended to prevent. We must always be mindful lest the Sherman Act be invoked perversely in favor of those who seek protection against the rigors of competition.

Id. at 273; *see also* Telex Corp. v. IBM Corp., 510 F.2d 894, 925-27 (10th Cir.), *cert. denied*, 423 U.S. 802 (1975); United States v. Aluminum Co. of America, 148 F.2d 416, 430 (2d Cir. 1945) ("The successful competitor, having been urged to compete, must not be turned upon when he wins."); 3 P. AREEDA & D. TURNER, *supra* note 16, ¶¶ 621-622; *see generally* Breyer, *The Problem of the Honest Monopolist*, 44 ANTITRUST L.J. 194 (1975).

[18] Monopolies are covered under § 2 of the Sherman Act. 15 U.S.C. § 2 (1976); *see generally* 3 P. AREEDA & D. TURNER, *supra* note 16, ¶¶ 614-739. For a critical discussion of recent developments in the law governing a monopolist's conduct, see Sullivan, *Monopolization: Corporate Strategy, the IBM Cases, and the Transformation of the Law*, 60 TEX. L. REV. 587 (1982).

By analogy to the operation of a patent, monopoly pricing may be regarded as a way of generating profits to reward an innovator. *See* 3 P. AREEDA & D. TURNER, *supra* note 16, ¶ 622(a), at 59; *cf.* R. POSNER, ANTITRUST LAW 13 n.7 (1976) (government may grant a monopoly to encourage certain kinds of activity). *But see* Williamson, *Dominant Firms and the Monopoly Problem: Market Failure Considerations*, 85 HARV. L. REV. 1512, 1524 n.41 (1972) (reward for superior performance should not last indefinitely); Turner, *The Scope of Antitrust and Other Economic Regulatory Policies*, 82 HARV. L. REV. 1207, 1216, 1220-21 (1969).

[19] *See* United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 348 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954); *see also* Elzinga, *The Antimerger Law: Pyrrhic Victories?*, 12 J. L. & ECON. 43 (1969) (arguing that divestiture of unlawfully merged firms is often ineffective).

[20] *See* 3 P. AREEDA & D. TURNER, *supra* note 16, ¶ 710, at 149; *cf.* United States v. Aluminum Co. of America, 148 F.2d 416, 427 (2d Cir. 1945) (difficulty of telling whether a price charged by a monopoly is reasonable).

tion that characterizes a monopoly achieved through internal growth. Therefore they typically lack the benefits needed under the rule of reason to offset the harmful effects on resource allocation caused by distorted pricing.[21] For this reason, antitrust law is much more hostile to price fixing than to monopolies.

From experience with recurring situations, courts have developed per se rules to cut off litigation of certain issues that ordinarily must be resolved under the harm-benefit analysis of the rule of reason.[22] In essence these per se rules are derived from an application of stare decisis to the rule of reason.[23] Given the complexity of determining economic benefit and harm, the use of per se rules saves a significant amount of judicial time and resources.

One such rule states that an agreement to fix prices is per se illegal.[24] The agreement is conclusively presumed to have caused harm. Thus, in order to establish liability a plaintiff need not prove that the agreement affected prices in actual transactions.[25] Moreover, the per se rule conclusively presumes that the harm outweighs any benefits derived from the agreement. Defendants are therefore not permitted to introduce evidence to support a contention that, even if prices were fixed, there was a net benefit to society. The justification for this presumption is that the alleged benefits fall into familiar categories that have been rejected in the past as unlikely, hard to establish, insignificant, and in any event accompanied by the relatively greater harm associated with the successful fixing of prices.[26] As with any application of stare decisis,

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[21] *See* P. AREEDA, *supra* note 5, ¶ 206(a), at 167; Barnett, Hills, Applebaum & Pollock, *Interview With William F. Baxter*, 51 ANTITRUST L.J. 23, 35 (1981); *cf.* United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945) (monopoly from internal growth may bring benefits lacking in monopoly from merger).

In addition, the costs incurred in creating and defending monopolies and cartels may differ. R. POSNER, *supra* note 18, at 11-14. The costs of maintaining a cartel may be especially high because a number of firms must cooperate and secrecy is necessitated by the threat of criminal prosecution. The Antitrust Division routinely brings criminal prosecutions against price fixers but files only civil complaints against monopolists.

[22] *See, e.g.*, Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 9 (1979); Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

[23] *Cf.* United States v. Topco Assocs., 405 U.S. 596, 607-08 (1972) ("It is only after considerable experience with certain business relationships that courts classify them as *per se* violations of the Sherman Act."); *see also infra* note 27 and accompanying text.

[24] United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 222-24, 224 n.59 (1940).

[25] *See* United States v. Trenton Potteries Co., 273 U.S. 392, 397-98 (1927).

[26] *See* P. AREEDA, *supra* note 5, ¶ 312, at 329. Countries purporting to permit price fixing

however, it is conceivable that a defendant could successfully distinguish his case from the precedents supporting the per se rule. Thus, he might argue that the benefits flowing from the restraint to which he was a party differ from the benefits rejected in the previous decisions and that these benefits justify creating an exception to the per se rule.[27]

B. Conscious Parallelism

Firms in an industry with sufficiently few sellers to be characterized as an oligopoly may be able to achieve a price above marginal cost, even though they communicate their intentions only through the implicit signals embodied in each firm's announcements of pricing policies.[28] Whether such consciously parallel pricing policies have in fact been assisted by more direct communication is usually difficult to determine. In almost every instance of parallel pricing it is possible that no explicit communication took place.[29]

If successful, conscious parallelism based on implicit price signaling creates the same harm as an explicit agreement to fix prices. In each, there is a substantial likelihood that the selling price will be raised above marginal cost, and the benefits producers claim from consciously parallel pricing resemble the benefits that have been asserted for price fixing.[30] Nevertheless, there are two widely held objections to declaring consciously parallel pricing a violation of the antitrust laws.[31] These objections, one doctrinal and one practical, inhibit direct attacks on parallel pricing. In response, a

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when benefits outweight harm almost never allow the restraint after evaluation. *Cf.* Pengilley, *Public Benefit in Anticompetitive Arrangements? Australian Experience Since 1974*, 23 ANTITRUST BULL. 187, 192-98, 218 (1978); Pengilley, *Comments on Arguments in Justification of Agreements in Restraint of Trade—The United Kingdom, Australian, and New Zealand Experience*, 19 ANTITRUST BULL. 257, 261-80 (1974).

[27] *Cf.* United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 556 (E.D. Pa. 1960) ("The Supreme Court of the United States did not purport in the Northern Pacific case [Northern Pac. Ry. v. United States, 356 U.S. 1 (1958)] to anticipate all of the possible circumstances under which a tying arrangement might be used."), *aff'd per curiam*, 365 U.S. 567 (1961).

[28] *See, e.g.*, P. AREEDA, *supra* note 5, ¶ 261(a), at 271.

[29] *Cf. id.* ¶ 324(a)-(b), at 371 (either conscious parallelism or explicit communication is a possible explanation for similar prices in an oligopoly); *id.* ¶ 325, at 372 ("But query whether the factors sometimes relied upon [to find an agreement] imply anything more than mere interdependence.").

[30] *Cf. infra* notes 74-79 and accompanying text (alleged benefits of basing-point pricing).

[31] *See* P. AREEDA, *supra* note 5, ¶¶ 324-25; Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962).

number of indirect methods of attacking conscious parallelism have developed.[32] For example, horizontal merger law has been relied on to limit the possibilities of consciously parallel pricing,[33] legislation to permit breaking up firms in an oligopoly has been proposed,[34] and certain exchanges of information among competitors have been held unlawful on the ground that the exchanges facilitate conscious parallelism.[35]

The doctrinal objection to a direct antitrust attack on "mere" conscious parallelism is that firms engaging in parallel pricing should not be found to have entered into an agreement unless the factfinder concludes that an agreement was explicitly communicated. Phillip Areeda has characterized the cases as nearly unanimous in declaring that conscious parallelism alone does not constitute the contract, combination, or conspiracy called for in section 1 of the Sherman Act.[36] This view is implicit in decisions that permit the factfinder to infer an agreement to fix prices from evidence of a pattern of parallel pricing when augmented by a "plus factor," such as a discussion of prices among the defendants.[37] The plus factors persuade the factfinder that, rather than mere conscious parallelism, an explicit communication of an agreement took place.[38]

Yet proof of an explicit agreement is not demanded by any lin-

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[32] *See generally* Brodley, *Oligopoly Power Under the Sherman and Clayton Acts—From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285 (1967).

[33] *See, e.g.*, United States v. Aluminum Co. of America, 377 U.S. 271, 280 (1964) ("It would seem that the situation in the aluminum industry may be oligopolistic. As that condition develops, the greater is the likelihood that parallel policies of mutual advantage, not competition, will emerge.").

[34] For a discussion of two proposals, see P. AREEDA, *supra* note 5, ¶ 266. For another proposal, see C. KAYSEN & D. TURNER, ANTITRUST POLICY 266-69 (1959).

[35] *See* United States v. United States Gypsum Co., 438 U.S. 422, 456-57 (1978); United States v. Container Corp. of America, 393 U.S. 333, 337 (1969); *cf.* Posner, *Information and Antitrust: Reflections on the* Gypsum *and* Engineers *Decisions*, 67 GEO. L.J. 1187, 1197-99 (1979) (favoring illegality of mere conscious parallelism when harm is likely, yet arguing that certain exchanges of information should be permitted).

[36] P. AREEDA, *supra* note 5, ¶ 325, at 372 n.16; *see, e.g.*, North Carolina v. Chas. Pfizer & Co., 384 F. Supp. 265, 283-86 (E.D.N.C. 1974), *aff'd*, 537 F.2d 67, 75-76 (4th Cir.), *cert. denied*, 429 U.S. 870 (1976).

[37] *See* P. AREEDA, *supra* note 5, ¶ 325, at 373-82. "Plus" factors constitute "a web of circumstantial evidence pointing very convincingly to the ultimate fact of agreement." Delaware Valley Marine Supply Co. v. American Tobacco Co., 297 F.2d 199, 205 n.19 (3d Cir. 1961), *cert. denied*, 369 U.S. 839 (1962).

[38] *See* P. AREEDA, *supra* note 5, ¶ 325, at 372-73.

guistic or conceptual difficulty in characterizing conscious parallelism as an agreement. Richard Posner noted an analogy between conscious parallelism and the unilateral contract formed when the finder of a lost dog, by complying with the specified condition in an offer of reward, communicates acceptance through actions rather than words. Similarly, in conscious parallelism, the communication of both the offer and the acceptance may occur through actions rather than words: one seller may communicate his offer by restricting output; his rivals may accept this offer by restricting their outputs.[39] The result is "a literal meeting of the minds," a mutual understanding, even if there is no overt communication.[40]

Moreover, a *verbal* offer may be found in most instances of conscious parallelism. Areeda has suggested that a firm's public announcement of a plan to increase its list price can fairly be characterized as an invitation to other firms to match this increase.[41] Such an announcement satisfies the criterion for liability set forth by Justice Stone in *Interstate Circuit, Inc. v. United States*:[42] "It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that the others were asked to participate; each knew that cooperation was essential to successful operation of the plan."[43]

Doctrinal insistence on finding an overt agreement has the awkward effect of shielding conscious parallelism from the reach of section 1 of the Sherman Act, even though the harm caused by an increase in price above the competitive level is the same whether or not it results from overt agreement.[44] The shield of course is imperfect because through consideration of plus factors a factfinder may condemn under section 1 conduct that arguably was due only to conscious parallelism.[45]

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[39] R. POSNER, *supra* note 18, at 72.

[40] *Id.* at 74.

[41] P. AREEDA, *supra* note 5, ¶ 324(d), at 371.

[42] 306 U.S. 208 (1939).

[43] *Id.* at 226.

[44] *See* R. POSNER, *supra* note 18, at 41, 54-55.

[45] P. AREEDA, *supra* note 5, ¶ 325. Plywood manufacturers who, in Boise Cascade Corp. v. FTC, 637 F.2d 573 (9th Cir. 1980), escaped liability under § 5 of the Federal Trade Commission Act because proof of either an agreement or an effect on price was lacking were later found by a jury to have violated § 1 of the Sherman Act. *In re* Plywood Anitrust Litig., 655 F.2d 627 (5th Cir. 1981), *cert. granted*, 456 U.S. 971 (1982), *appeal dismissed per settle-*

The second objection to declaring "mere" parallel pricing unlawful is rooted in the practical uncertainty that exists in drawing a line between full-fledged conscious parallelism, which is certainly unreasonable, and a firm's simple consideration of the impact its price will have on the pricing policies of its rivals, a consideration that seems both innocuous and impossible to prevent. Donald Turner has expressed this concern most forcibly.[46] Suppose that firms practicing conscious parallelism were found to have violated section 1. How could an enforceable injunction against further wrongful parallelism be phrased? Turner offered two examples of unworkable formulations. An injunction prohibiting each defendant from taking into account his rivals' reactions to his pricing decisions would "demand such irrational behavior that full compliance would be virtually impossible."[47] An injunction ordering a defendant to set a price equal to cost would require the determination in enforcement proceedings of issues analogous to those arising in public utility rate regulation, a task for which courts are ill-suited.[48] Turner's testing of the proposed line between legal and illegal parallelism by asking whether particular injunctions would be enforceable is illuminating, for an injunction is, in essence, a restatement of the rule of liability drafted to fit the defendant's circumstances.[49]

Difficulty in formulating an enforceable injunction as a bright-line test, however, should not preclude liability. A contract not specifically enforceable nevertheless creates valid obligations, and damages can be recovered for its breach.[50] Indeed, not all injunctions are precisely worded. Many civil rights injunctions contain a provision that essentially repeats the statutory or constitutional command: "Do not discriminate on the basis of race."[51] The fundamental proposition of antitrust law, the rule of reason, states that,

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ment, 103 S. Ct. 3100 (1983). These defendants paid the plaintiff class $165 million in settlement after the Supreme Court had granted certiorari to review the Fifth Circuit's affirmance of the jury verdict. 54 INDUS. NEWS REP. (MOODY'S) 2942 (Jan. 23, 1983).

[46] Turner, *supra* note 31, at 657-84.

[47] *Id.* at 669.

[48] *Id.* at 669-70; *see also* 3 P. AREEDA & D. TURNER, *supra* note 16, ¶ 841(a), at 362-63; *cf.* Hay, *supra* note 9, at 441 n.7 (finding it implausible to expect a firm with few rivals to behave as though it had many).

[49] O. FISS, THE CIVIL RIGHTS INJUNCTION 8-9, 12-18 (1978).

[50] E.A. FARNSWORTH, CONTRACTS 832 (1982).

[51] O. FISS, *supra* note 49, at 13.

unless a per se rule has been announced, the legality of a practice depends on a comparison of its harm and benefits. Although many courts are reluctant to have contempt sanctions turn on such an elaborate inquiry, liability for treble damages results if this balancing inquiry is resolved against a defendant. The Supreme Court has even authorized criminal liability for a defendant who knows that the consequences of his conduct would be anticompetitive.[52]

Richard Posner contends that coordinated pricing resulting in a limitation on output and a higher than competitive price should be held to violate section 1 of the Sherman Act even if no evidence of an overt agreement exists.[53] The merit of this proposal is in making liability turn on whether a defendant's activities were economically harmful.[54] Posner acknowledges the possibility that under this approach a firm which had not in fact sought to match its rivals' prices might erroneously be found liable, but he responds that the problem of erroneous decisions pervades many areas of the law. Protection against error, Posner argues, could be better obtained by imposing a higher standard of proof when the only evidence of collusive conduct is economic harm than by insisting on evidence of an overt agreement before liability attaches.[55]

Those persuaded by Turner's demand for a bright-line test of liability have been unwilling to condemn mere conscious parallelism but have argued instead for more precise descriptions of practices that facilitate conscious parallelism.[56] Suppose, for example, that in a given industry predisclosure by individual firms of planned price changes was declared unreasonable. It would probably be easy to decide whether an order clearly prohibiting predisclosure had been violated. Existence of an issue as to the reasonableness of a particular instance of predisclosure then would not be a bar to holding that activity unlawful; rather, the test would be whether the general practice can be described with sufficient preci-

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[52] United States v. United States Gypsum Co., 438 U.S. 422, 444-46 (1978).

[53] R. POSNER, *supra* note 18, at 71-75; *see also* L. SULLIVAN, ANTITRUST 355-58 (1977) (section 1 should be read as governing conscious parallelism). For endorsements of the application of § 2 of the Sherman Act to oligopolists jointly possessing power over price, see *id.* at 361-64; 3 P. AREEDA & D. TURNER, *supra* note 16, ¶¶ 840-846.

[54] R. POSNER, *supra* note 18, at 54-55.

[55] *Id.* at 75.

[56] *See* Turner, *supra* note 31, at 675-78; 3 P. AREEDA & D. TURNER, *supra* note 16, ¶ 841(a); Hay, *supra* note 9, at 468-69, 480-81.

sion that it is easy to determine whether a defendant has engaged in the practice. Similarly, basing-point pricing is a facilitating device that can be subjected to such a prohibition. Simply prohibit sellers from refusing to offer their customers the option of purchasing FOB.[57]

In sum, the practical objection to an attack on conscious parallelism—that illegal practices should be clearly describable—can be overcome if unreasonable facilitating practices are forbidden. The doctrinal objection to a direct antitrust attack, however, remains and is strengthened by the recent refusals of the Second and Ninth Circuits in the absence of proof of horizontal agreements to enforce Federal Trade Commission orders issued against individual firms under section 5.[58]

III. Basing-Point Pricing as a Practice that Facilitates Conscious Parallelism

For conscious parallelism to work, each seller must attempt to match rather than undercut the prices of its rivals. This practice is not feasible unless sellers can identify a specific price that each can match and still maintain satisfactory market shares for all. Product diversity makes it difficult to calculate a suitable price for each seller's product.[59] Even when the products are homogeneous, diversity exists if transportation costs are significant and sellers' plants have different locations.[60]

Significant transportation costs confer on each seller a freight advantage for sales within a region near his plant. Suppose that, instead of adopting delivered pricing, each producer was willing to sell FOB at his plant. Any producer with a mill price equal to that

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[57] Turner, *supra* note 31, at 675-78; *see* Triangle Conduit & Cable Co. v. FTC, 168 F.2d 175, 179 (7th Cir. 1948) (individual employment of basing-point pricing condemned as an unfair trade practice under § 5 of the FTC Act), *aff'd sub nom.* Clayton Mark & Co. v. FTC, 336 U.S. 956 (1949) (equally divided Court).

[58] *See supra* notes 3-10 and accompanying text.

[59] *See* P. Areeda, *supra* note 5, ¶ 262(d), at 274-75; R. Posner & F. Easterbrook, *supra* note 14, at 337. For an explanation of the problem two individuals face when trying to arrive at a matching result without communicating with each other, see T. Schelling, The Strategy of Conflict 54-67 (1960). This problem is complicated in the oligopoly context because each seller has an incentive to increase his sales by secretly setting his price a little below the price which his rivals are matching. *See id.* at 48-49; *see generally* Hay, *supra* note 9, at 448-49; *cf. supra* notes 14-15 and accompanying text (homogeneity aids price-fixing).

[60] *See* F. Scherer, *supra* note 13, at 325.

of his rivals would then be able to make all the sales within his freight advantage territory, and the fortuities of location would give some rivals larger sales territories than others. Suppose now that the producers attempted through conscious parallelism to keep their mill prices equal and above marginal cost, while continuing to sell FOB. A mill with a smaller freight advantage territory would be tempted to sell to customers outside its territory by reducing its mill price below the desired oligopoly level and absorbing the additional transportation costs the customer would otherwise incur. In order to maintain oligopolistic cooperation, firms with large territories might be willing to tolerate some invasion by firms with smaller territories, but there is no bright-line test to identify the incursions that would be permitted. In the absence of a bright line, consciously parallel maintenance of uniform mill prices would be difficult to effectuate.[61]

A further difficulty would arise for a mill-pricing oligopoly in which firms with large territories permitted firms with smaller territories to invade. If buyers provided their own transportation, an invader could absorb freight costs only by charging the most distant buyer a lower mill price than that charged a customer inside the invader's normal freight advantage territory. This would amount to price discrimination, and price discrimination with a homogeneous product is ineffective unless resale is prevented. Otherwise the customer benefiting from the invasion could profitably resell the product near the mill of the invader, thus damaging the invader's price structure in his home territory.[62]

The barrier to oligopoly pricing created by spatial differentiation may be overcome by use of a basing-point system, of which there are several varieties.[63] The basic idea may be illustrated by the pricing method challenged in *Boise Cascade*. In this case, sellers in the southern part of the United States quoted to a given customer a delivered price that consisted of a uniform mill price plus the rail freight charge from the west coast to the zone in which the cus-

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[61] *Id.* at 326-27. An oligopolist who uses FOB mill pricing and is tempted to cut prices to enlarge his own territory would find that after retaliatory price cutting each oligopolist had the territory with which he started but was now selling at a lower price. "And each will soon recognize that they will not endow many libraries through such uncooperative tactics." *Id.* at 327.

[62] Such resale by a lower priced buyer is known as "arbitrage." *Id.* at 315.

[63] *See id.* at 327-29; Note, *supra* note 3, at 1196-97.

tomer was located.[64] With such a formula, a delivered price could be calculated for each customer, and every seller could match that price by following the formula.[65] Although, depending on their distance from the west coast, customers in different zones encountered different delivered prices, every seller quoted a particular customer the same price. Thus, standardization as to each customer of the sum of the mill price and transportation cost was accomplished by calculating freight charges from a fixed reference point, the west coast, rather than from each seller's plant.

Essential to successful employment of a basing-point system is the refusal by each firm to sell FOB at his mill. Otherwise an alternative final price would be available to a customer willing to provide his own transportation from the mill. This price would equal the sum of the actual freight cost and the mill price. The price would depend on the customer's distance from the seller and would not be identical to the price yielded by the basing-point formula. To prevent alternative pricing and to ensure the success of their basing-point system, the defendants in *Boise Cascade* refused to sell FOB.[66]

IV. The Pervasive Unreasonableness of Basing-Point Pricing

The per se rule against price fixing avoids the expense of time-consuming litigation with little loss in accuracy of decision. A rule of reason inquiry would almost always conclude that price fixing is illegal because any alleged benefits are illusory, infrequent, and trivial when compared to the harm resulting from misallocation of resources.[67]

A basing-point system facilitates conscious parallelism, which results in the same harms as does explicit price fixing. Under a basing-point system, prices exceed marginal cost by more than they otherwise would, and thus resource allocation is distorted.[68] In addition, wasteful expenses and nonprice competition are stimu-

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[64] Boise Cascade Corp. v. FTC, 637 F.2d 573, 574 (9th Cir. 1980). The formula used in *Boise Cascade* set up concentric bands running North to South and radiating eastward from Portland, Oregon. *Id.*

[65] A famous example is the submission of identical sealed bids of $3.286854 per barrel by eleven cement firms. FTC v. Cement Inst. 333 U.S. 683, 713 n.15 (1948).

[66] 637 F.2d at 578.

[67] *See supra* notes 24-26 and accompanying text.

[68] *See supra* note 16.

lated.[69] Because a customer must pay the same price no matter from whom he buys, basing-point systems encourage the excessive use of transportation services.[70] Sellers have an incentive to adopt the mode of transportation on which the delivered-pricing formula is based, even if another mode is cheaper, in order to forestall buyer requests for a rebate.[71] Finally, the price discrimination between zones that is inherent in a basing-point system causes further misallocation of resources.[72] Plants are likely to be located inefficiently as buyers seek to be close to the basing point.[73]

Similarly, the benefits claimed for basing-point pricing are as specious as the benefits asserted for price-fixing. For example, the defendants in *Boise Cascade* argued that basing-point pricing satisfied buyer preferences for a form of price quotation which facilitated comparison with the west coast price.[74] The Ninth Circuit panel gave some credence to this argument by asserting that the FTC had failed to prove use of the system by southern producers was not "a natural competitive response to buyer preference for traditional forms of price quotation."[75] Yet the familiar rule of reason inquiry as to whether a less restrictive alternative is available undermines this justification for the practice of delivered pricing.[76] In this case, a less restrictive alternative is obvious: the defendants could have offered buyers a choice between adhering to the delivered pricing system and purchasing FOB.[77] A similar justification for a horizontal agreement to eliminate granting short term credit

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[69] *See* P. AREEDA, *supra* note 5, ¶ 318(d), at 349 n.36 (limitation of international airline cartel to service of sandwiches to economy class; after several carriers began serving elaborate meals on a slice of bread, six criteria were adopted to define a "sandwich"); F. SCHERER, *supra* note 5, at 330, 331 n.42 (high selling expenses under basing-point pricing).

[70] *See* F. SCHERER, *supra* note 13, at 330-31.

[71] *See id.* at 331-32; F. MACHLUP, THE BASING-POINT SYSTEM 190-202 (1949).

[72] *See infra* notes 96 & 116 and accompanying text.

[73] F. SCHERER, *supra* note 13, at 332-33; Note, *supra* note 3, at 1199 n.40.

[74] 637 F.2d at 578.

[75] 637 F.2d at 581.

[76] *See, e.g.*, IBM Corp. v. United States, 298 U.S. 131, 138-40 (1936) (requirement in lease of tabulating machine that cards used with machine meet specifications would be a less restrictive alternative than tying purchase of cards to lease of machine).

[77] Other justifications for delivered pricing based on alleged buyer preferences have been suggested. *See* Carlton, *A Reexamination of Delivered Pricing Systems*, 26 J. L. & ECON. 51, 65, 69 (1983) (reduction of transactions costs; simplicity; allocation of uncertainty of transportation costs to seller; toxicity of product). All such justifications fail because an offer by defendant of an opportunity to purchase FOB is a less restrictive alternative.

was once accepted as a potential defense by the Ninth Circuit: competition might be enhanced by the increased visibility of prices made possible by the elimination of credit.[78] The Supreme Court reversed the Ninth Circuit and held that an agreement to eliminate credit was merely a form of price fixing. Since price fixing agreements have been adjudged to lack redeeming virtues, the trial court could not consider any justification based on the challenged agreement's informing function.[79]

When transportation costs comprise a relatively small percentage of a product's price, a more appealing justification, of course, supports delivered pricing. For example, price quotations are simplified when some mail order houses charge the same delivered price to customers in all locations.[80] Price matching, however, is not a characteristic of the mail order industry, and the harms from conscious parallelism are not present.[81] Moreover, with relatively low transportation costs, delivered pricing may not entail a refusal to sell FOB. If the transaction cost of arranging his own transportation is high relative to the transportation cost, a customer would be genuinely uninterested in an offer to sell FOB.[82]

Explicit horizontal agreements to adopt a basing-point system have regularly been held illegal.[83] Since the harm caused by facilitating conscious parallelism outweighs the specious benefits that may accompany basing-point pricing, a single firm's use of such a system would always fail an examination under the rule of reason. Thus, if a combination can be established so that section 1 of the Sherman Act applies, basing-point pricing should be declared ille-

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[78] Catalano, Inc. v. Target Sales, Inc., 605 F.2d 1097, 1099 (9th Cir. 1979), *rev'd*, 446 U.S. 643 (1980).

[79] 446 U.S. 643, 649 (1980).

[80] *See* Carlton, *supra* note 77, at 65.

[81] *Cf.* Note, *supra* note 3, at 1200, 1215-16 (advocating per se illegality under § 5 of the Federal Trade Commission Act when the same pricing scheme is used throughout the industry, buyers and sellers are geographically dispersed, and sellers refuse to sell FOB).

[82] The tying analysis outlined in this Article, *see infra* notes 85-136 and accompanying text, by means of the less restrictive alternative argument, neatly carves out from per se illegality an exception for delivered pricing justified by the unimportance of transportation costs. In tying law, cost savings tend to support a conclusion that there is no tie. *See, e.g.*, ILC Peripherals Leasing Corp. v. IBM Corp., 448 F. Supp. 228, 232 (N.D. Cal. 1978), *aff'd*, 636 F.2d 1188 (9th Cir.), *cert. denied*, 452 U.S. 972 (1981).

[83] *See* United States v. FMC Corp., 306 F. Supp. 1106, 1151 (E.D. Pa. 1969) (agreement not to adopt a given site as a basing point held a per se violation of § 1 of the Sherman Act); see also the survey of cases in Note, *supra* note 3, at 1201-03.

gal per se. Only the doctrinal difficulty of the agreement problem remains to bar a broad condemnation of basing-point pricing under section 1.[84]

V. Basing-Point Pricing as a Tying Arrangement

There is no need to struggle to find a horizontal agreement when an individual firm uses a basing-point pricing system. With each sale the firm imposes on its customer a vertical restriction that is essentially a tying arrangement. The application of section 1 of the Sherman Act to a vertical agreement between a firm and its customer is familiar.[85] Once a tie is found, condemnation of the arrangement as per se illegal almost always follows upon the satisfaction of two criteria: (1) the tie must have a substantial effect in the market for the tied good, measured by a relatively small sum of dollars, and (2) the firm must possess the requisite degree of power in the market for the tying good.[86] For a typical firm employing basing-point pricing, it will be relatively easy to demonstrate the satisfaction of these criteria.

A. *The Existence of a Tie*

When a firm using basing-point pricing refuses to sell FOB at its plant, it imposes on its customers a tie between its product and the transportation of that product. The main product, such as plywood, is the tying good; transportation is the tied good.[87] An agree-

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[84] *See supra* notes 36-45 and accompanying text.

[85] *See, e.g.,* L. Sullivan, *supra* note 53, at 374-500.

[86] *See, e.g.,* Fortner Enters. v. United States Steel Corp., 394 U.S. 495, 500-06 (1969) (*Fortner I*). For an exception to the per se rule, see United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 555-58 (E.D. Pa. 1960), *aff'd per curiam,* 365 U.S. 567 (1961).

[87] Although § 3 of the Clayton Act does not apply because transportation is not a "commodity," § 1 of the Sherman Act fills the jurisdictional gaps. *See* Northern Pac. Ry. v. United States, 356 U.S. 1, 4-7 (1958). Section 3 of the Clayton Act provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the *goods, wares, merchandise, machinery, supplies,* or *other commodities* of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or under-

ment embodying this tie is created when a customer purchases plywood at the basing-point price.

Since the test for per se illegality is relatively easy to satisfy, the firm's main hope of escaping liability is to contend that a tie does not exist. In particular, the firm may argue that there is really only one product involved: delivered plywood. Just such an argument was thoughtfully analyzed in *Anderson Foreign Motors v. New England Toyota Distributor*,[88] where Judge Garrity observed that the issue is "basically normative . . . should the seller be forced to market the products separately?"[89]

One factor nonetheless likely to influence the decision whether a firm is selling one product or two is not normative but conceptual: which characterization is more consistent with ordinary language? Plywood and transportation seem quite obviously to be separate products. To speak of "delivered plywood" as a single product is artificial. Referring to an automobile, the *Anderson* court suggested a distinction that helps elucidate this seemingly self-evident point. In its undelivered state, the product is able to perform all the functions for which it was designed. In its delivered state, the product's ability to perform these functions remains unchanged and no further qualities have been added.[90] Accordingly, the Uniform Commercial Code treats the undelivered item as the fundamental unit, and, unless otherwise agreed by the parties, the place for delivery of goods is the seller's place of business.[91]

A sale of two items in fixed proportions may suggest that the firm is selling only one product.[92] The *Anderson* court also consid-

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> standing may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

15 U.S.C. § 14 (1976) (emphasis added).

[88] 475 F. Supp. 973 (D. Mass. 1979) (manufacturer held to have tied transportation to sale of automobiles when it sold only at delivered prices).

[89] *Id.* at 982.

[90] The *Anderson* court stated:

> The automobile product and the delivery service do not naturally merge into a third identifiable unit. Moreover, the finished Toyota automobile . . . is able to perform all the functions for which it was designed. Delivering it to the dealer's location adds nothing to the automobile *qua* automobile. In short, there is no relationship between the car and its delivery inherent in the nature of the automobile itself and thus no conceptual barrier to treating the two as separate products.

Id.

[91] U.C.C. § 2-308(a) (1978).

[92] *See* Turner, *The Validity of Tying Arrangements Under the Antitrust Law*, 72 HARV.

ered a variation of this argument. The defendant in *Anderson* claimed that it sold transportation services in fixed proportion to its main product, Toyota cars, in the sense that purchasing dealers were not required to pay for transportation services beyond those needed for their purchases of Toyotas.[93] This argument strains the use of the term "fixed proportion." In the economist's sense, transportation services are used in variable proportions when, for a given amount of a product, the seller provides a different amount of transportation to each customer, depending on the customer's location.[94] The chief significance of variable proportions as an indicator of a tying arrangment is that a tie is often used to exploit a monopoly position by price discrimination.[95] In fact, price discrimination is an inherent characteristic of basing-point pricing, although the system differs in one respect from more typical examples of price discrimination. In the former, the customers who pay more are those farther from the basing point. In the latter, higher prices are paid by persons having a more intense demand for the tying good.[96] Although ultimately rejecting the defendant's argument, the *Anderson* court did suggest that the defendant's single-product defense was helped by the fact that the defendant's customers were not required to purchase transportation services beyond those actually needed.[97] In this respect the case for rejecting the single-product argument is even stronger with basing-point pricing than in *Anderson*. Under a basing-point pricing system,

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L. REV. 50, 72 (1958); Note, *Product Separability: A Workable Standard to Identify Tie-In Arrangements Under the Antitrust Laws*, 46 S. CAL. L. REV. 160, 167-68 (1972).

[93] 475 F. Supp. at 982-83.

[94] *See, e.g.*, C. FERGUSON, MICROECONOMIC THEORY 114-15 (rev. ed. 1969).

[95] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4388 n.23 (U.S. Mar. 27, 1984); United States Steel Corp. v. Fortner Enters., 429 U.S. 610, 617-18 (1977) (*Fortner II*); P. AREEDA, *supra* note 5, ¶ 531(b), at 735. For a more general analysis, see Burstein, *A Theory of Full-Line Forcing*, 55 NW. U.L. REV. 62 (1960). By collecting more money from customers who are willing to pay more, the monopolist makes higher profits than if he charged the same price to all customers. The amount of the tied good used often measures the intensity of the customer's desire for the tying good. For example, the number of cards used with a computer is correlated with the usefulness of the computer to the customer. A tying arrangement may, however, be profitable even though the customer does not use the tied good in conjunction with the tying good. *See id.* at 74-76, 85-86.

[96] *See* F. SCHERER, *supra* note 13, at 327-29. Customers who pay more under basing-point pricing are accidental victims of a clumsy facilitating device designed not to augment industry profits through price discrimination, but merely to cause prices to rise above marginal cost.

[97] 475 F. Supp. at 982.

many customers are billed for phantom freight.

A related argument in favor of a single-product theory is that a firm is selling a single product when the firm never sells one of the two "components" without the other.[98] Of course, continuing the previous example, tying theory by definition recognizes that the tying good, plywood, is never sold without the tied good, transportation. The defendant's argument would have to be based on the additional fact that, if he is like most basing-point practitioners, the manufacturer sells transportation services only in conjunction with sales of plywood.

The answer to this argument, however, is that in a number of tying cases liabilty was found even though the defendants sold the tied good only in connection with the tying good.[99] Moreover, practitioners of basing-point pricing employ a formula that treats the mill price and the transportation charge from the basing point as independent components of the delivered price. Separate treatment of these costs strongly suggests that both buyer and seller regard the basic product and its transportation as separate items.[100]

A seller might argue that the parallel use of delivered pricing by other firms in the industry demonstrates in practical terms the existence of a single product, for example, plywood with transportation. Judge Garrity disposed of such a contention in *Anderson:* "All firms in an oligopolistic market . . . might use the same economically inefficient, but financially lucrative, tie-in. If the uniformity of the practice were determinative, a clearly suspect tying arrangement would often be insulated from *per se* scrutiny."[101] Moreover, in a case like *Boise Cascade* this argument is refuted by

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[98] *See* United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 559 (E.D. Pa. 1960), *aff'd per curiam,* 365 U.S. 567 (1961); *see also* Kugler v. AAMCO Automatic Transmissions, Inc., 337 F. Supp. 872, 874-75 (D. Minn. 1971) (advertising not tied to purchase of franchise since advertising and franchise are always sold together in the industry), *aff'd,* 460 F.2d 1214 (8th Cir. 1972).

[99] *See, e.g.,* Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39, 42, 44, 46 (5th Cir. 1976); Siegel v. Chicken Delight, Inc., 448 F.2d 43, 48 n.4 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972).

[100] *See* United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 559 (E.D. Pa. 1960), *aff'd per curiam,* 365 U.S. 567 (1961); *see also* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4391 (U.S. Mar. 27, 1984); Anderson Foreign Motors v. New England Toyota Distrib., 475 F. Supp. 973, 983 (D. Mass. 1979); Kugler v. AAMCO Automatic Transmissions, Inc., 337 F. Supp. 872, 874-75 (D. Minn. 1971), *aff'd,* 460 F.2d 1214 (8th Cir. 1972).

[101] 475 F. Supp. at 983.

the fact that at the retail level plywood is often sold without transportation. Finally, for most products sold under a basing-point pricing system, no significant savings in cost seem to result if the seller rather than the buyer arranges for the transportation.[102]

Altogether apart from the single-product argument is the contention that the seller merely "purchases" transportation services for resale and therefore is not an active competitor in the tied-good market.[103] This contention can also be met by citation of precedent. Arrangements are routinely characterized as ties even though defendants purchased the tied good for resale to their customers.[104]

B. *Sufficient Effects in the Tied Good Market*

Once a tie has been found, courts apply a two-pronged test for determining per se illegality. The first prong requires a substantial effect in the market for the tied good. This is satisfied merely by showing that a tie has affected annual sales in the tied good market worth $500,000.[105] When firms adopt a basing-point system, the product is usually heavy and bulky, so transportation costs are high. For example, in *Boise Cascade* each plywood producer's annual use of transportation services easily exceeded the threshold amount.[106]

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[102] The pertinence of this criterion is discussed *supra* note 82 and accompanying text.

[103] Thus the seller arguably would not be covered by the language of § 3 of the Clayton Act on which tying law under § 1 of the Sherman Act is based. *See supra* notes 11 & 87.

[104] *See supra* note 99. Moreover, an illegal tie exists if a seller requires his customers to purchase the tied good from a third company that in turn pays a rebate to the seller. *E.g.*, Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc., 585 F.2d 821, 834-35 (7th Cir. 1978), *cert. denied*, 440 U.S. 930 (1979); Osborn v. Sinclair Ref. Co., 286 F.2d 832, 834, 839-40 (4th Cir. 1960), *cert. denied*, 366 U.S. 963 (1961).

[105] Fortner Enters. v. U.S. Steel Corp., 394 U.S. 495, 501-02 (1969) (*Fortner I*); Northern Pac. Ry. v. United States, 356 U.S. 1, 7-8 (1958); International Salt Co. v. United States, 332 U.S. 392, 395-96 (1947). Smaller sums have been held "not insubstantial." Aqua Flame, Inc. v. Imperial Fountains, Inc., 463 F. Supp. 736, 740 n.10 (N.D. Tex. 1979) ($74,250); Detroit City Dairy, Inc. v. Kowalski Sausage Co., 393 F. Supp. 453, 472 (E.D. Mich. 1975) ($86,376.72). To date, apparently no defendant has argued that the dollar figures in earlier cases should be adjusted to reflect inflation, although in most cases the threshold of substantiality would still be easily cleared. For a discussion of the issues created by inflation when statutes refer to fixed dollar amounts, see G. CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 40, 65-68 (1982).

[106] In 1971, for example, the lowest production by any of the five defendants was Willamette's 1,001,523 thousand square feet on a ⅜ inch basis. Boise Cascade Corp., 91 F.T.C. 1, 13 (1978), *enforcement denied*, 637 F.2d 573 (9th Cir. 1980). Following an example in the opinion, 91 F.T.C. at 43 n.75, a minimum freight charge for Willamette may be calculated on the

In the unlikely event that a firm's basing-point charges for transportation total less than $500,000, a plaintiff may successfully argue that the sales figure in the tied good market for the individual defendant should be considered together with the aggregate sales of the other sellers using similar tying arrangements.[107] Moreover, a tying arrangement which does not satisfy the "effects" prong of the test for per se illegality may still be declared unreasonable.[108] Because basing-point pricing is almost always harmful, the plaintiff should prevail in such a rule of reason inquiry.[109] Indeed, this inquiry would merely be a special case of the more general proposition that an unreasonable vertical restriction is unlawful.[110]

C. *Power to Require a Tie*

The second prong of the test for per se illegality of a tying arrangement requires sufficient economic power in the market for the tying good. Justice Stevens has written the last two opinions of the Supreme Court that addressed this issue. In *United States*

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assumption that all shipments were made to the freight zone closest to the west coast on January 29, 1971, *id.* at 33, using the standard formula for translating thousands of square feet on a 3/8 inch basis into pounds, *id.* at 30-31. The freight cost then equals 1,001,523 thousand square feet multiplied by 1125 pounds per thousand square feet multiplied by $0.46 per 100 pounds, or a total of $5,182,881.53.

In imitating the sample calculation, it is assumed that there are two errors in the FTC's opinion: the freight rates, *id.* at 33, should be given as "per hundred pounds" rather than "per thousand pounds," and the association weights, *id.* at 31, should be given as "per thousand square feet" rather than "per thousand pounds." Even if the freight rate were $0.46 per thousand pounds, however, the transportation sales for Willamette would equal $518,288.15, which still exceeds $500,000.

[107] United States v. Loew's Inc., 371 U.S. 38, 41-43, 49 (1962). In *Loew's,* film distributors engaged in block booking, i.e., selling films to television stations only in a package and refusing to sell individual films separately. The parallel use of block booking seems to have affected adversely the Court's evaluation of the legality of an individual firm's conduct, since the Court discussed the effect of all 25 contracts together and found a violation by a firm which had received only $60,800 in total payments. *Cf.* Signode Steel Strapping Co. v. FTC, 132 F.2d 48, 54 (4th Cir. 1942) (cease and desist orders entered upon findings that three companies had 2/3 to 3/4 of the market for the tying goods and a considerable percentage of the market for the tied good, a large volume of trade was affected, and thus a substantial lessening of competition resulted).

[108] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4392-93 (U.S. Mar. 27, 1984) (when test for per se illegality not satisfied, a rule of reason inquiry must be undertaken); Fortner Enters. v. United States Steel Corp., 394 U.S. 495, 499-500 (1969) (*Fortner* I) (failure to satisfy two-prong tying test simply means that defendant's conduct is not per se illegal).

[109] *See supra* notes 67-84 and accompanying text.

[110] *See infra* text accompanying note 138.

Steel Corp. v. Fortner Enterprises (Fortner II),[111] Justice Stevens concluded that prior decisions of the Court "focus attention on the question whether the seller has the power within the market for the tying product, to raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market."[112] In *Jefferson Parish Hospital District No. 2 v. Hyde,*[113] he stated that tying arrangements are unlawful "when the seller has some special ability—usually called 'market power'—to force a purchaser to do something he would not do in a competitive market."[114]

The forcing of burdensome terms upon buyers obviously occurs in a basing-point system, since buyers farther from the basing point than from the nearest seller must pay phantom freight. Purchases of the tied good at prices above the market price provide convincing evidence, absent any other explanation, that the seller has sufficient power in the market for the tying good to "forc[e] purchases that would not otherwise be made."[115]

The price discrimination that results from the payment of phantom freight under a basing-point pricing system is inconsistent with a completely competitive market in which firms lack power over price.[116] With competition, differentials in profitability in serving different customers would disappear as firms cut prices to make sales to the more attractive customers. Under a basing-point system, the differentials persist. Moreover, since customers who yield the least profit continue to be supplied, customers being

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[111] 429 U.S. 610 (1977).

[112] *Id.* at 620.

[113] 52 U.S.L.W. 4385 (U.S. Mar. 27, 1984).

[114] *Id.* at 4388.

[115] *Id.* at 4392; *see also Fortner* I, 394 U.S. 495, 504 (1969); Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39, 48 (5th Cir. 1976). Refusing to allow customers to purchase transportation separately is also burdensome because it facilitates conscious parallelism, which would not occur in a competitive market.

[116] *See* R. POSNER, *supra* note 18, at 63; *cf. Fortner* II. The Supreme Court in *Fortner* II stated:

> In some tying situations a disproportionately large volume of sales of the tied product resulting from only a few strategic sales of the tying product may reflect a form of economic "leverage" that is probative of power in the market for the tying product. If, as some economists have suggested, the purpose of a tie-in is often to facilitate price discrimination, such evidence would imply the existence of power that a free market would not tolerate.

429 U.S. at 617.

served at higher profit are clearly paying a price greater than marginal cost.

In an industry with a basing-point pricing system, the power of each firm to impose a tie results primarily from an oligopolistic market structure rather than monopoly power.[117] An individual firm's power to insist on tying transportation services to its main product is derived in large part from the simultaneous refusal of its rivals to sell FOB, just as its power to set a price above marginal cost is augmented by the unwillingness of its rivals to expand production rather than by their inability to do so. When market power is used to force unwilling buyers to accept a tie, however, the source of that power should be irrelevant. Even if market power stems from superior economic performance, its misuse to impair competition on the merits in a separate market is illegal per se.[118] A fortiori, the misuse of economic power stemming from conscious parallelism, which lacks the benefits often associated with monopoly power,[119] should also be illegal per se.[120] Section 3 of the Clayton Act, the core around which tying law developed,[121] does not refer to the source of the economic power used to limit customer choice.[122]

The Supreme Court has twice indicated that the failure of competitors to offer to sell the tying good and the tied good separately plays an important role in determining whether a seller has sufficient power to force a tie on buyers.[123] Similarly, Professor Areeda

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[117] *Cf.* P. AREEDA, *supra* note 5, ¶ 246(a), at 243 (suggesting a distinction between oligopoly and monopoly power).

[118] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4388-89 (U.S. Mar. 27, 1984).

[119] *See supra* notes 17-18, 21 & 30 and accompanying text.

[120] In N.W. Controls, Inc. v. Outboard Marine Corp., 333 F. Supp. 493 (D. Del. 1971), a firm was found to have illegally tied remote control cables to its outboard engines. The market for outboards was highly concentrated. *See* Yamaha Motor Co. v. FTC, 657 F.2d 971, 974 (8th Cir. 1981) (In 1973, four firms had 94.9% of the United States market in terms of units sold.), *cert. denied*, 456 U.S. 915 (1982). Thus, the defendant's market power might well have depended on conscious parallel pricing by its rivals in the market for the tying good.

[121] *Cf.* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4387-88 (U.S. Mar. 27, 1984) (congressional finding made in Clayton Act concerning the competitive consequences of tying must be respected in a Sherman Act case).

[122] *See supra* notes 11 & 87.

[123] *See Jefferson Parish Hosp.*, 52 U.S.L.W. at 4388 ("If each of the products may be purchased separately in a competitive market, one seller's decision to sell the two in a single package imposes no unreasonable restraint on either market, particularly if competing sup-

has concluded that, when a seller "offers an A-B package purchased by the plaintiff who is unable to buy A alone from that seller or anyone else," a tie is apparently present.[124] This conclusion was also reached in a case where three companies had at least two-thirds of the sales in the tying good market; each firm was

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pliers are free to sell either the entire package or its several parts."); Northern Pac. Ry. v. United States, 356 U.S. 1, 7 (1958) ("[I]f one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition if its competitors were ready and able to sell flour by itself.").

[124] P. AREEDA, *supra* note 5, ¶ 541, at 763. Relying on the following language in Justice Stevens' *Fortner* II opinion, a defendant might argue that an oligopolist's power cannot be the basis for imposing liability for an illegal tie:

> In short, the question is whether the seller has some advantage not shared by his competitors in the market for the tying product. Without any such advantage differentiating his product from that of his competitors, the seller's product does not have the kind of uniqueness considered relevant in prior tying-clause cases. . . . "Uniqueness confers economic power only when other competitors are in some way prevented from offering the distinctive product themselves."

United States Steel Corp. v. Fortner Enters., 429 U.S. 610, 620-21 (quoting *Fortner* I, 394 U.S. 495, 505 n.2 (1969)). Twice elsewhere in *Fortner* II Justice Stevens noted the lack of evidence that the defendant, United States Steel Corp., had a cost advantage over other sellers, who in this case were lenders of credit. 429 U.S. at 617, 622.

Fortner II, however, was not a case in which competitors in the market for the tying good also refused to sell the tying good separately. The plaintiff alleged an illegal tie, with the tied good being steel components for a prefabricated house that was sold at a price above the market price and the tying good being credit provided at an interest rate below the market rate for such a loan. In these circumstances, the only possible source of power to force the plaintiff to buy unwanted steel would have been a cost advantage in the credit market. Thus, Justice Stevens concluded that, instead of having the power to force the plaintiff to buy its steel, the defendant had simply been willing to accept a lesser profit or incur greater risks than its competitors: "The usual credit bargain offered to Fortner proves nothing more than a willingness to provide cheap financing in order to sell expensive houses." 429 U.S. at 612 n.1, 618, 621-622.

Justice Stevens also noted that "[t]he tie-in in this case can be explained as a form of price competition in the tied product. . . ." *Id.* at 619 n.10. A tie embodying a disguised price cut that may have procompetitive effects in destabilizing conscious parallelism differs significantly from basing-point pricing, in which typically the price for the package of the main product and transportation is not below the price competing firms charge for that package but rather is exactly equal to that price. The former tie may produce at least as much benefit as it does harm; the latter tie does not.

The former kind of tie is illustrated by unsystematic freight absorption, in which a seller selectively offers a delivered price embodying a freight charge that is less than the actual cost of transportation. Some economists regard this practice as desirable because it tends to stimulate price competition. *See* F. SCHERER, *supra* note 13, at 330; Kaysen, *Basing-Point Pricing and Public Policy*, 63 Q. J. ECON. 298, 313 (1949); Stocking, *The Law on Basing-Point Pricing: Confusion or Competition*, 2 PUB. L. 1, 27-28 (1953). Under *Fortner* II, unsystematic freight absorption embodying a disguised price cut would not constitute an illegal tie.

found to have engaged in the illegal tying.[125]

Considering the conduct of others in determining the legality of a vertical agreement is not new to antitrust law. The effects of one firm's tying arrangement have been judged in light of the use by competitors of similar ties.[126] Moreover, the adoption of similar practices by other firms is relevant to an assessment of the effects of exclusive dealing,[127] a practice related to tying.[128] Such an analysis of the power of an individual firm in an industry with basing-point pricing does not require imposition on the defendant of any sort of horizontal responsibility for the parallel practice. Instead, a vertical agreement between the individual defendant and his cus-

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[125] Signode Steel Strapping Co. v. FTC, 132 F.2d 48, 50 (4th Cir. 1942). *Cf.* Moore v. Jas. H. Matthews & Co., 550 F.2d 1207, 1211-12, 1215-16, 1220 (9th Cir. 1977) (remanding for trial tying claims against eight cemeteries accounting for 78% of interments in a given county, when five had independently adopted one restriction and all eight had independently adopted another restriction; no suggestion that existence of parallel practices negated individual power). In addition to a firm's power to impose a tie when its competitors impose a similar tie, a firm adopting basing-point pricing may also have some individual monopoly power resulting from its location or product differentiation. Spatial differentiation of producers is a precondition for developing a basing-point pricing system. Though the system prevents a spatial advantage from being reflected in the price, the closest mill may be able to offer quicker service. Moreover, the gap between price and marginal cost gives each firm an incentive to differentiate its product, which may be done, for example, by using salesmen when other firms do not. *See supra* note 69.

The market power requirement for per se illegality is satisfied by a relatively modest degree of product differentiation. *See, e.g.*, United States v. Loew's Inc., 371 U.S. 38, 45-48 (1962) (individual variations in each copyrighted film confirm the presumption of market power that results from the existence of the copyright); Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39, 48 (5th Cir. 1976) (market power found where franchisor advertised for franchisees throughout the Southwest and had a well-known public image). *But cf.* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 52 U.S.L.W. 4385, 4392 (U.S. Mar. 27, 1984) (hospital did not have market power within its neighborhood when 70% of patients residing in that neighborhood chose other hospitals).

[126] *See supra* note 107.

[127] FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392 (1953). In *Motion Picture*, the Supreme Court stated:

> [D]ue to the exclusive contracts, respondent and the three other major companies have foreclosed to competitors 75 percent of all available outlets for this business throughout the United States. It is, we think, plain . . . that a device which has sewed up a market so tightly for the benefit of a few falls within the prohibitions of the Sherman Act . . . .

Id. at 395; *see also* Standard Oil Co. v. United States, 337 U.S. 293, 295 (1949) (discussing parallel use of exclusive dealing by others and finding illegal effect on competition); P. AREEDA, *supra* note 5, ¶¶ 565-66, at 823-24 (percentage of foreclosure by similar agreements should affect the evaluation of an exclusive dealing arrangement).

[128] *See* P. AREEDA, *supra* note 5, ¶ 557, at 809; *id.* ¶ 561, at 819.

tomer is solely identified and examined to reveal that the agreement results in considerable harm without significant redeeming virtue.

D. Per Se Illegality of the Tying Arrangement

The conclusion that basing-point pricing is pervasively unreasonable, which follows from a comparison with price fixing,[129] also follows a fortiori from a comparison with a conventional tying arrangement that satisfies the test for per se illegality. The policy ground for condemning the more familiar tying arrangement is that the tie interferes with competition on the merits in the market for the tied good.[130] Basing-point pricing similarly interferes with competition on the merits. Purchasers of the main product are precluded from choosing among available transportation services. Moreover, under a basing-point system many customers must pay for phantom freight, so the effective charge for transportation exceeds the competitive market price. Conventional tying arrangements, in comparison, are held illegal even though the price charged for the tied good is not above the competitive market price for that good.[131] In fact, a competitive conditions clause permitting a buyer to escape from the tie when a lower rate for the tied good can be found does not save an otherwise illegal tie.[132]

The price discrimination implicit in a basing-point pricing system in addition is more harmful than the price discrimination facilitated by conventional tying arrangements.[133] While the price discrimination often caused by a conventional tie has an allocative effect that is difficult to assess,[134] the arbitrary price discrimination

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[129] *See supra* notes 67-84 and accompanying text.

[130] *See, e.g., Jefferson Parish Hosp.*, 52 U.S.L.W. at 4388-89; Fortner Enters. v. United States Steel Corp., 394 U.S. 495, 503-04, 508-09 (1969) (*Fortner I*); *see also* P. AREEDA, *supra* note 5, ¶ 530, at 732-33. Commentators have attacked the "competition on the merits" rationale as being unsound. *See, e.g.*, R. POSNER, *supra* note 18, at 174-76; Baker, *The Supreme Court and the Per Se Tying Rule: Cutting the Gordian Knot*, 66 VA. L. REV. 1235, 1267-74 (1980).

[131] *See* N.W. Controls, Inc. v. Outboard Marine Corp., 333 F. Supp. 493, 521 (D. Del. 1971); *see also* Burstein, *supra* note 95, at 67 n.21 (citing judicial precedent and secondary authority).

[132] Northern Pac. Ry. v. United States, 356 U.S. 1, 11-12 (1958); International Salt Co. v. United States, 332 U.S. 392, 396-97 (1947).

[133] *See* Burstein, *supra* note 95, *passim*; *supra* notes 67-73 & 122 and accompanying text.

[134] *See Jefferson Parish Hosp.*, 52 U.S.L.W. at 4394 n.2 (O'Connor, J., concurring); R. POSNER, *supra* note 18, at 64-65, 176-84.

resulting from basing-point pricing undoubtedly misallocates resources.[135] Finally, basing-point pricing causes harm not usually associated with tying arrangements: it facilitates conscious parallelism.[136]

VI. Basing-Point Pricing as an Illegal Vertical Agreement Even If Not Deemed a Tying Arrangement

Even if the arrangement is not characterized as a tie, a buyer's acceptance of an offer conditioned by the seller's refusal to sell FOB creates an illegal vertical agreement when tested under the rule of reason.[137] Indeed, the pervasive unreasonableness of basing-point pricing requires per se illegality.[138] Thus, evidence justifying a basing-point arrangement should not be admissible, nor should courts require a plaintiff to prove an effect on price in order to establish liability.[139]

VII. Some Consequences of Liability Based on Vertical Analysis

A. *Remedies*

Remedying a firm's illegal use of basing-point pricing presents no unusual difficulties, for an enforceable injunction is easy to draft. The firm must offer to sell FOB.[140] Attempted evasion by subterfuge, of course, is theoretically possible. For example, a firm might quote an unrealistically high FOB price, thus forcing its cus-

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[135] *See supra* notes 72-73 and accompanying text.

[136] Recent studies of two leading tying cases demonstrate that the arrangements may have facilitated price fixing or conscious parallelism in the market for the tied good. *See* Cummings & Ruhter, *The Northern Pacific Case*, 22 J. L. & Econ. 329, 342-50 (1979) (concluding that in Northern Pac. Ry. v. United States, 356 U.S. 1 (1958), purpose of tying arrangement with competitive conditions clause was to gather information on price and non-price competition in an industry where rate bureaus had established lawful price-fixing agreements); Peterman, *The International Salt Case*, 22 J. L. & Econ. 351, 360-62 (1979) (suggesting that in International Salt Co. v. United States, 332 U.S. 392 (1947), tie with competitive conditions clause might have served to monitor price cutting if a cartel or conscious parallelism existed in the market for the tied good).

[137] The same conclusion follows if basing-point pricing is characterized as a tie but the requirements for per se illegality are not satisfied. *See supra* notes 108-09 and accompanying text.

[138] *See supra* notes 67-84 and accompanying text.

[139] Note, however, that harm must be established to recover treble damages. *See infra* notes 144-47 and accompanying text.

[140] *See supra* note 57 and accompanying text.

tomers to "choose" purchasing on a delivered-pricing basis. As with other subterfuges intended to disguise a tie,[141] however, detection in this case would pose relatively simple factual issues. The package price quotation plus any savings in transaction costs[142] can easily be compared to the FOB price quotation plus the lowest freight rate available. If the former is consistently less than the latter—that is, if the FOB price exceeds the package price minus the transportation cost and if this excess cannot be justified by cost-savings resulting from delivery by the seller—then the injunction has been violated.[143]

In proving damages a plaintiff may wish to use tying precedents in which courts have awarded three times the amount by which the price paid for the tied good exceeded the market price.[144] Phantom freight paid by the plaintiff constitutes such an overcharge.[145] Some tying cases, however, have required plaintiffs to prove that the price paid for the package of tying and tied goods exceeded the combined market prices for these goods.[146] Accordingly, a plaintiff might have to prove what the market price for the main product would have been in the absence of basing-point pricing.[147] In any

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[141] *See* United States v. Loew's Inc., 371 U.S. 38, 52-56 (1962) (modifying decree to prevent future disguised tie). For a discussion of the issues in drafting such a decree, see P. AREEDA, *supra* note 5, ¶ 545(a), at 770; *id.* ¶ 546(d), at 772.

[142] Any savings in transaction costs are probably trivial.

[143] Permitting a firm to offer transportation plus the main product as a package that embodies a disguised price tends to destabilize conscious parallelism. For this reason some economists favor a regime of unsystematic discriminatory freight absorption. *See supra* note 124.

[144] *See, e.g.*, Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39, 50-51 (5th Cir. 1976).

[145] *See In re* Plywood Antitrust Litig., 655 F.2d 627, 631-32 (5th Cir. 1981) (jury awarded amount of phantom freight as damages for conspiracy to impose basing-point pricing), *cert. granted*, 456 U.S. 971 (1982), *appeal dismissed per settlement*, 103 S. Ct. 3100 (1983).

[146] *See, e.g.*, Siegel v. Chicken Delight, Inc., 448 F.2d 43, 52-53 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

[147] Defendants have speculated that the price for the main product could have been increased had basing-point pricing not been employed. *See* Boise Cascade Corp. v. FTC, 637 F.2d 573, 580 (9th Cir. 1980) (court accepts "common-sense proposition that southern producers would simply adjust the index price upwards if they were quoting delivered prices in terms of actual freight"). Such speculation is unsound. Even a single firm's abandoning a system of basing-point pricing would tend to destabilize conscious parallelism and cause the effective price level for the package of main product and transportation to fall. *See supra* notes 59-62 and accompanying text. The adoption of basing-point pricing reflected each defendant's business judgment that conscious parallelism would work poorly without that facilitating device. Otherwise, they would not have incurred the wasteful transportation costs that basing-point pricing entails. *See* Smithies, *Aspects of the Basing-Point System*, 32 AM.

event, a plaintiff near the basing point who paid little or no phantom freight might still seek damages based on the theory that conscious parallelism facilitated by basing-point pricing inflated the market price for the main product.

Proving the effect of an illegal practice on market price presents statistical difficulties. Confronted by these difficulties, an antitrust plaintiff need merely introduce evidence from which a just and reasonable estimate of damages can be made, provided he first establishes that some damage occurred.[148] If the damage issue is tried after basing-point pricing has ended, perhaps as a result of preliminary injunctive relief, before-and-after evidence of the impact on prices will be available.[149] In any event, a plaintiff can argue that the mill price used in the basing-point formula must have exceeded marginal cost, at least for producers making sales at the mill price to customers at the basing point. If there are many producers, the plaintiff may argue persuasively that without basing-point pricing the mill price would have equaled marginal cost and thus would have been at least as low as the mill price used in the basing-point formula. The defendant should not be permitted to speculate that, even without basing-point pricing, conscious parallelism would have kept the market price above marginal cost. Conscious parallelism violates public policy.[150] It escapes antitrust enforcement only because of doctrinal and remedial difficulties.[151]

As injunctive relief and the threat of damages induce the abandonment of basing-point pricing, wasteful cross hauling will be eliminated. Enhanced price competition is likely to result, and the average sum paid for the main product and transportation should fall.[152]

B. *Advantages of Vertical Analysis Over the Use of Section 5 of the Federal Trade Commission Act*

A cease and desist order issued under section 5 of the Federal

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ECON. REV. 706, 710-12 (1942).

[148] *See, e.g.*, Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 263-66 (1946).

[149] For a thorough account of the effective use of such evidence, see C. BANE, THE ELECTRICAL EQUIPMENT CONSPIRACIES: THE TREBLE DAMAGE ACTIONS 328-38, 369-78 (1973).

[150] *See supra* notes 68-79 and accompanying text.

[151] *See supra* notes 31 & 36-58 and accompanying text.

[152] *See supra* note 147; *cf.* F. MACHLUP, *supra* note 71, at 204-08 (decrease in package price to be expected from adoption of uniform mill pricing).

Trade Commission Act may seem to have an advantage in avoiding the vagaries of private antitrust enforcement with its retroactive penalties.[153] This advantage is illusory. Private enforcement facilitates the detection of antitrust violations and tends to cause expenditures for enforcement to vary in accordance with the harm resulting from the violation.[154] Courts have sufficient expertise to evaluate the benefits and harms of basing-point pricing, since these resemble the benefits and harms of price fixing. Fear of unfair surprise from the application of retroactive penalties is unwarranted.[155] Firms that practice basing-point pricing have always risked litigation by plaintiffs attempting to prove the existence of explicit collusion and thus a violation of section 1 of the Sherman Act.[156] Moreover, the use of tying law suggested in this Article involves the application of accepted precedents to a defendant's unilateral refusal to quote prices FOB. Liability in treble damages suits for conduct that was public and not previously adjudicated as unlawful is a familiar phenomenon.[157]

VIII. CONCLUSION

Once the fact that basing-point pricing establishes vertical agreements is recognized, the agreement objection to applying section 1 of the Sherman Act is overcome, and the practice may be judged on its economic merits.[158] So judged, the practice is per se illegal. The elimination of basing-point pricing should diminish the

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[153] *See* P. AREEDA, *supra* note 5, ¶ 574, at 833; *supra* notes 5-6 and accompanying text.

[154] For a discussion of the advantages of private enforcement, see Becker & Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974). For a further discussion of its advantages and disadvantages, see R. POSNER, ECONOMIC ANALYSIS OF LAW 461-67 (2d ed. 1977).

[155] For a discussion of unfair surprise resulting from retroactive penalties, see P. AREEDA, *supra* note 5, ¶ 574, at 833.

[156] *See supra* note 45 and accompanying text.

[157] *See, e.g.*, Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975).

[158] This vertical agreement analysis overcomes the agreement problem in the case of at least one other device that may facilitate conscious parallelism. A price protection or most favored customer clause in a contract between a buyer and seller typically guarantees the buyer the lowest price paid by any other customer. *See* Hay, *supra* note 9, at 455-56, 473 n.130. Obviously, a vertical agreement is present. The issue under § 1 is whether this agreement fails a test under the rule of reason. For a discussion of the reasonableness of most favored customer clauses, see S. Salop, Practices that (Credibly) Facilitate Oligopoly Coordination (Nov. 11, 1982) (unpublished manuscript) (available at Georgetown University Law Center). *See also* Clark, *Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices After* Ethyl Corp., 1983 WISC. L. REV. 887, 901-02, 932-35.

misallocations caused by conscious parallelism in those industries that have adopted this practice.

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