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# Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information

Saul Levmore

# Essay

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## I. Background: Cartels and Free Riders

A familiar problem in the theory of antitrust law is whether the law should allow or forbid restrictions in the distribution of a good.[1] A convenient illustration concerns a manufacturer who produces blue jeans and markets them through clothing and department stores. Should the manufacturer's refusal to deal with any retailer who sells the jeans for less than a manufacturer-announced price violate the antitrust laws?

If the manufacturer is permitted to enforce this resale price "agreement," cartelization by the retailers may result. Any market power this cartel may control is easily eroded by new retailers entering the market and underselling the manufacturer-announced prices. The barriers to entry are almost nonexistent for new retailers because consumers are willing to shop in low-rent basements for these marvelous pants. Thus, existing retailers need a mechanism to keep out new and lower-priced retailers. They can enlist the manufacturer as their enforcer by indirectly paying the manufacturer not to deal with any retailer who breaks the cartel by selling below the manufacturer's price. In this manner, a vertical restraint may be imposed by the manufacturer at the direction, by purchase or coercion, of the retailers. But this retailer cartel rests on unsteady ground. Eventually it will face competition from retailers who sell the jeans of other

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1. The case law has moved from the Rule of Reason, in which specific facts and markets are examined for their anticompetitive elements, to the per se illegality of vertical restrictions, and then, at least insofar as nonprice restrictions are concerned, back to a limited Rule of Reason. *Compare* White Motor Co. v. United States, 372 U.S. 253, 263 (1963), *and* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 59 (1977), *with* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382 (1967). While this Essay reviews the essentials of this antitrust issue, a number of seminal selections will be helpful to the uninitiated reader. *See generally* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pt. 2), 75 YALE L.J. 373 (1966); Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

designers. If the potential for interbrand competition is low, then the manufacturer has monopoly power and maximizes its monopoly profits by charging a higher than competitive price to the retailers.[2] Thus, the retailer cartel theory against allowing resale price restrictions requires the existence of one cartel for each manufacturer or that retailers can make it difficult for new manufacturers to enter the industry.[3]

Vertical restrictions may be designed instead to form manufacturer cartels. A number of blue jeans' producers may agree to restrict output, but each may find it tempting to cheat on its cohorts by lowering prices and increasing output. It is difficult for any member of this cartel to police the agreement unless each spies upon the others' business. A more effective method of enforcing the cartel is to compare prices at the *retailer* level. At this stage, it is easier to police pricing and output policies because the jeans are on the shelves and price tags are easily inspected. Thus, a prospective member of the producer cartel might adopt a resale price maintenance program—and stop dealing with any retailer who offers the pants at a lower price—in order to meet that cartel's pricing requirements. These producer cartels are as difficult to maintain as retailer cartels because of the inability of any cartel member to respond to market changes. Moreover, the manufacturer will lose the benefits that derive from various retailers' offering different mixes of prices and services unless a multi-tier resale price program is enacted.[4]

On the other hand, vertical restrictions may be used to improve distribution patterns and consumer awareness rather than to extract cartel profits. A manufacturer might, for example, wish to introduce a new washing machine with unusual features and solid construction. Although consumers can be introduced to this new product through advertisements, the manufacturer may discover that the qualities of the machine are better demonstrated and highlighted on the showroom floor. However, retailers will find it profitable to use the services that are provided by competitor retailers.[5] A "discounter" will tell potential customers that they should go to a more service-oriented store to learn about various washing machines and then return to the discounter to purchase the product. The discounter can charge lower prices than other stores because it provides a paucity of service, showrooms, and information. Eventually, the stores providing these services will either stop providing the services, or worse, go out of business. In turn, the manufacturer's attempt to introduce a different washing machine will fail because consumers will not learn of the new product's features and advantages.

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2. *See* R. BORK, THE ANTITRUST PARADOX 295 (1978).
3. *See* Bork, *supra* note 1, at 405-10.
4. *See id.* at 411-13.
5. This exploitation of competitor retailers is the essence of the "free-rider problem." For another skeptical view, see F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 586 (2d ed 1980).

A vertical restriction, such as resale price maintenance, does a fairly good job of protecting the manufacturer's and consumers' interests in introducing the new washing machine. By refusing to deal with any retailer who sells the product for less than a price that allows for the provision of showrooms and information, the manufacturer will rid the market of any discounters whose free-riding strategy hampers the ultimate success of its new product. Without price competition, remaining retailers will compete with each other by offering greater services.

Of course, there are other ways for the manufacturer to overcome the free-rider problem. Each of these plans, however, limits the manufacturer's flexibility and places various obstacles in the way of introducing the new product.[6] For example, the manufacturer might do its own retailing. Although it is conceivable that such a vertically integrated enterprise might be designed to promote a manufacturer cartel, this amalgamation can serve to ensure that consumers receive an optimal mix of information and demonstrations. The plan, although solving the free-rider problem, may be unattractive to a manufacturer that knows little about retailing or has difficulty attracting the necessary capital. In addition, a manufacturer may sense that consumers prefer to compare the machines of several manufacturers and do not trust a salesperson who is an employee of the manufacturer. Finally, it may be impractical for the manufacturer to pay retailers according to a schedule of services provided.[7]

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6. Even resale price maintenance generates some inflexibilities in defeating the discounter. The optimal marketing strategy might involve more dealer services in some neighborhoods than in others. But resale price maintenance does not sufficiently overcome the problem posed by discounters to permit varying levels of service among dealers. To some extent, the manufacturer will be able to mix its strategies by imposing minimum resale prices on all dealers, but selling directly to some customers at lower prices. Still, it is fair to note that each of these attempts by the manufacturer to overcome the discounter will incur some costs.

7. Under such a plan, the manufacturer might offer to pay $X for each showroom and $Y for each salesperson that is employed by the retailer. Similarly, the retailer could be reimbursed for a percentage of such expenses. The impracticality of such a solution to the free-rider problem results from the costs of enforcement. The manufacturer must check to see that these services were provided and that they were not used to benefit the manufacturer's competitors. It will be difficult to arrive at a schedule of subsidies that sufficiently overcomes the free-rider problem and also does not present windfalls to the retailer. Manufacturers might estimate the overall showroom and personnel needs for a region and then take bids with the lower bidder earning the amount bid in return for providing information to consumers. Such a plan might encourage competing bidders to police the results for the manufacturer. It does not appear that this strategy has ever been tried by a manufacturer. In any event, it is also inexact—the manufacturer must compare bids for showrooms in good locations with bids for services in less desirable locations—and generates a different set of problems concerning the effectiveness of competition among bidders. For example, the manufacturer must determine how to treat next year's bids because this year's winner will have an advantage and some monopoly power if the sale of showrooms and fixtures is required. These problems are similar to those encountered in any plan that tries to dismantle a regulatory regime in favor of a bidding system.

Thus, the imposition of a vertical restriction, such as resale price maintenance, may be economically efficient or inefficient. A restriction may support monopolistic horizontal agreements involving retailers or producers. However, a vertical restriction that is identical in appearance may promote the introduction of useful products that otherwise would be stifled by the free-rider problem. Some commentators hypothesize that a distribution restriction such as resale price maintenance is much more likely to be indicative of an attempt to overcome the free-rider problem than it is a signal of an undesirable cartel.[8] One commentator has gone even further by suggesting that vertical restrictions should be per se legal; if the restrictions are harmful they ought to be dealt with by attacking any horizontal collusion and not by destroying every vertical restriction.[9]

The law once treated vertical restrictions as per se illegal and continues to do so in the case of a price restriction.[10] This posture derives from a fear that manufacturer or retailer cartels are supported and maintained by such vertical restrictions. More recently, the legality of nonprice vertical restrictions has been determined by the Rule of Reason.[11] This transformation is explained by the increasing awareness that the free-rider problem exists and may be solved by the imposition of vertical restrictions. Thus, courts ought to weigh the benefits to consumers of the increased services that follow a vertical restriction against the possibility that the restriction in question is a symptom of harmful horizontal (manufacturer or retailer) collusion. Although a vertical restriction may be a symptom of cartelization, it is not harmful in and of itself and may be a desirable strategy for overcoming the free-rider problem. In this last role, the vertical restriction obviates the need for manufacturers to do their own retailing, to innovate less, or to develop imperfect schemes to reimburse retailers directly for the ancillary services and showrooms they provide.

Before evaluating the wisdom of a per se or Rule of Reason standard in dealing with vertical restrictions, it is helpful to review the framework in which the choice of a standard is made. To the extent that antitrust law abhors the possibility of cartels, it has experimented with and settled on certain rules of thumb. For example, collusive price-fixing is treated as illegal per se, although it is unlikely that every instance of price-fixing is undesirable. There may be some industries in which the supernormal profits that can be earned under a price-fixing agreement would be instrumental in spurring innovation. Similarly, a collusive arrangement conceivably could yield price stability and certainty that, in turn, would encour-

8. *See* Bork, *supra* note 1, at 391; Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 22-23 (1981).

9. *See* Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 22 (1981).

10. Dr. Miles Medical Co. v. John Park & Sons Co., 220 U.S. 373, 408 (1911); Albrecht v. Herald Co., 390 U.S. 145, 151-52 (1968).

11. *See* note 1 *supra*.

age productive investment. Still, the exceptions to the general rule are rare enough so that the benefits of a per se rule convincingly outweigh its costs. Wisely, the law does not require a showing of either intentional price-fixing or harmful collusive effects. Instead, the law judges price-fixing to be per se illegal because the costs of demonstrating the illegal intentions of price-fixers and the harmful effects of horizontal associations exceed the costs to society of the per se rule, including occasional price instability and unfinanced innovations. In an analogous manner, rules of thumb do not require a showing of intentional price-fixing, but instead are satisfied with evidence that a number of sellers or bidders converged on similar prices.[12]

Insofar as the treatment of vertical restrictions is concerned, the danger of horizontal arrangements must not be disregarded as soon as vertical restrictions are recognized as potential solutions to the free-rider problem. If manufacturer or retailer cartels are genuine possibilities, then a difficult empirical question lies behind the decision to prefer a per se rule over a Rule of Reason. Although any horizontal agreement that lurks beneath a harmful vertical restriction can be attacked for its illicit "horizontality," it is far more difficult to prove the existence of a collusive agreement than it is to point to a manufacturer's insistence on a vertical restriction. If the free-rider problem were exceedingly rare (if, for example, manufacturer advertising were as effective as retailer showrooms) and retailer cartels were easy to maintain (perhaps significant barriers prevent new retailers from entering certain industries), then one might actually prefer a rule of per se illegality to the Rule of Reason. The costs of litigating and demonstrating the existence of a cartel are substantial, but few resources are wasted in proving a vertical restriction. While such a per se rule appears to be overkill, its costs are small because, by assumption, manufacturers would have almost no legitimate need for vertical restrictions.

The choice of a legal rule to deal with vertical restrictions requires a variety of inquiries. The frequency and ultimate cost of the free-rider problem needs to be determined.[13] The likelihood of, and losses from,

12. FTC v. Cement Inst., 333 U.S. 683, 713-16 (1948).

13. Although vertical restrictions may be necessary to deal with many different problems, it is really the free-rider issue that is consistently at the core of the manufacturer's objectives. It sometimes is argued that resale price maintenance helps the manufacturer combat dealer power. Albrecht v. Herald Co., 390 U.S. 145, 153 (1968). But this argument incorrectly assumes that a manufacturer, which once had the freedom to charge dealers as it wished, can somehow increase its profits by forcing dealers to sell to fewer customers at a higher retail price. *See* R. BORK, THE ANTITRUST PARADOX 291-98 (1978).

More specifically, it might be alleged that resale price maintenance allows the manufacturer to ensure that there will be widespread availability of a product at a price that is attractive to retailers. Similarly, it can be asserted that the manufacturer will seek to impose advertising requirements, territorial restrictions, or repair standards on dealers to assure adequate investment and promotion, attract dealers, or guarantee customer satisfaction. But absent some free-rider problem, there is every reason to believe that each of these objectives is in the interests of dealers as well as manufacturers. The dealer also will profit retailer and manufacturer cartels also should be examined. Finally, to the extent that there is *any* likelihood of cartelization, the costs of attacking horizontal agreements must be compared with the simplicity of exposing vertical restrictions. The next section of this Essay focuses on applying these criteria to the free-rider problem in the context of different types of consumer goods.

## II. "DOWNSTREAM" SOLUTIONS TO THE FREE-RIDER PROBLEM

The real cost of the free-rider problem is indicated by the cost of the manufacturer's next best marketing alternative. The manufacturer may be able to retail its own goods, in which case the cost of free-riding is measured by the manufacturer's relative disadvantage in the field of retailing. Alternatively, the manufacturer might switch to a more advertising-intensive selling strategy, in which case the cost of the free-rider problem derives from the relative disadvantage of advertising compared with some mix of manufacturer and retailer efforts in selling the product. The argument in favor of allowing vertical restrictions in distribution, either by a Rule of Reason or per se legality, depicts the manufacturer as solving its free-rider problem at the retail level. This is an "upstream" solution in the sense that the free-rider problem is overcome by an action farther back on the economic chain. The problem with such an upstream solution is that it might camouflage a manufacturer's support of a harmful horizontal cartel.

The place of the free-rider problem in the formulation of antitrust law is best understood by recognizing that there are alternatives to an upstream solution. The free-rider problem can be circumvented by means other than the manufacturer's decision to market its own products, pay retailers for their efforts, advertise on its own, or impose vertical restrictions. A "downstream" solution must not be ignored: consumers can unite and support independent valuations of products. Consumers who are quite skeptical of a manufacturer that, for example, advertises that its new washing machine can handle a variety of colors and fabrics simultaneously, may be impressed with such a claim by *Consumer Reports*. Thus, the services that retailers under provide as a consequence of the free-rider problem can be offered separately both upstream and downstream. Commentators who argue in favor of permitting vertical restrictions have relied on the frequent inefficiencies of upstream solutions and either ignore or assume other remedies for collusive arrangements supported by the allowed vertical

most when a product is optimally promoted and repaired. Instead, any genuine concern by a manufacturer stems from an understanding that some dealers will market the product in a sub-optimal way because that retailer will seek to take advantage of another dealer's efforts. Clearly, if there were just one retailer for each manufacturer, the latter would have no worries about the behavior of the former and would have no need to second guess the retailer by imposing vertical restrictions. Rather, problems arise when there is more than one retailer and each may try to exploit it competitors' services, leaving the manufacturer with an overall level of services that is unsatisfactory.

restrictions. But the argument in favor of permitting vertical restrictions misses the potential of downstream solutions in which services absent at the retailer level are provided by consumers, consumer-supported ventures, or some other source that is controlled by neither manufacturer nor retailer.

Certainly, the recognition of downstream solutions to the free-rider problem is not meant as a call for an immediate return to a standard of per se illegality for vertical restrictions. Moreover, the theoretical availability of downstream solutions does not imply that all manufacturers will be as satisfied with such solutions to the free-rider problem as they might be with upstream strategies. But recognition of downstream options is important in any case in which the downstream solution ought not to be terribly unattractive to a manufacturer and the danger of a restrictive cartel is formidable.

It is useful, then, to identify the conditions under which downstream solutions thrive. In analyzing a vertical restriction, a court then will be able to compare the likelihood of cartelization to the severity of the free-rider problem. The latter is great when it is difficult for the manufacturer itself to contract around the free-rider problem *and* when downstream solutions are least viable. In sum, vertical restrictions are appealing when both upstream and downstream solutions to the free-rider problem are unattractive.

The markets for washing machines and audio equipment appear to offer examples in which vertical restrictions should be scrutinized with some care. In neither of these markets do manufacturers or retailers enjoy obvious cartel power. But in applying the Rule of Reason, the inquiry must be extended to pursue consideration of the free-rider problem; a vertical restriction should be tolerated if it is the only workable solution. Unlike many other products, such as suitcases or clocks, washers and stereos are sold better when offered with information and demonstrations regarding their novel features. To the extent that this information can be provided in the retailer's showroom, it is easily appropriated and undermined by a free-riding discounter. Although at this point in the inquiry vertical restrictions concerning washers or stereos appear to be efficient remedies to the free-rider problem, Rule-of-Reason analysis must consider downstream alternatives. In fact, a consumer magazine or independent testing board actually may solve the manufacturer's marketing problem as successfully as the imposition of a vertical restriction. Such "downstream informers" can test various washers and stereos and then report their results to the consuming public. Manufacturers' needs often can be filled as well by a combination of discounting retailers and downstream informers as by retailers that both sell goods and provide information in one location. In some cases downstream informers may be more efficient providers of information.[14] A dealer's showroom normally houses one or two acoustical

14. If the downstream solution in this form really improves on the vertical restriction, then manufacturers would already know this and the marketplace, rather than an antitrust

settings and provides less information about the equipment's performance in the buyer's living room than might a downstream informer's study that compares audio systems in a variety of environments. Similarly, few consumers will have the time or personality to bring their dirty laundry to a showroom for a test run, but a downstream informer easily can report the performance of a machine armed with a given detergent.[15]

On the other hand, some product characteristics are difficult to describe downstream. For example, consumers may want to judge whether a potential acquisition will fit in with the decor of their living rooms. In many cases an independent test will be inadequate because the consumer requires some personal experience with the product. For example, magazine evaluations frequently indicate that buttons and dials are difficult to locate or that seatbelts are uncomfortable. Many buyers will learn that these factors are a function of one's personal taste or height. But this shortcoming of downstream evaluations does not necessarily indicate that a vertical restriction is the only remaining solution to the free-rider problem. Rather, it may indicate that some combination of downstream and nonvertical upstream actions is appropriate. The inadequacy of downstream evaluations may be remedied by fewer showrooms or salespeople than were required by a strategy relying entirely on retailers or the manufacturer itself for information. It now may be quite easy for the manufacturer to provide such information or pay retailers directly to maintain a limited number of samples for visual inspection.

Other products, however, such as blue jeans, are far less susceptible to downstream solutions. The consumer's primary need is for a dressing room and mirror in order to examine fit and style. Some consumers may want the advice of sales personnel, which is hardly provided in magazine reports. In applying the Rule of Reason, courts must recognize that for goods requiring the personal experience and evaluation of buyers, vertical restrictions deserve more deference because the free-rider problem is quite serious. If nonrestrictive upstream solutions are unavailable, perhaps because the manufacturer has no talent for retailing or monitoring, then a vertical restriction should be permitted unless sufficient market power exists to indicate camouflaged cartelization. Clearly, the market for blue jeans is less susceptible to a downstream solution than is the market for washers or stereos. This difference must be recognized in applying the Rule of Reason.

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rule, would accomplish the desired result. The text's optimism foreshadows the discussion in part III in which subsidies to the downstream informers are proposed as a way of helping these downstream alternatives overcome their own free-rider problems.

15. Somewhat farther downstream, consumers occasionally can experiment with different brands. A consumer might experiment with a neighbor's washer, television, automobile, or television antenna. Manufacturers are cognizant of these demonstrations beyond the showroom; for example, automobiles are sold at lower prices to rental car companies, partly because these companies, in passing, provide test-driving opportunities.

## III. Expanded Downstream Solutions

### *A. Return Policies*

The importance of solutions to the free-rider problem that avoid problematical vertical restrictions requires an inquiry into other available solutions. The most striking solution lies farthest downstream, altogether avoiding the midstream retailer. Through a mix of warranty and refund policies, a manufacturer may enable consumers to experience products in their intended settings, while preserving return rights.[16] To be sure, any such policy is impractical for a product such as an automobile, which is expensive to ship and typically available with so many options that a generous return policy creates a tremendous inventory problem. On the other hand, book clubs and some mail-order companies regularly market products in this returnable fashion by offsetting their shipping expenses and interest costs (while the product is out for inspection) with the savings that accrue from eliminating retailers.

It is tempting to assert that this direct marketing option is a feasible downstream solution for products of relatively low value (thus avoiding high interest costs) and low shipping costs. Although the Rule of Reason should recognize these distinctions among products, it is important to recognize that this "returnable" solution to the free-rider problem has not reached its potential. When a product is of relatively high value, the manufacturer may hesitate to bypass the free-rider problem with this "returnable" strategy because the manufacturer's capital is tied up in the product and interest income is forgone. This interest cost, however, can be shared by the manufacturer and potential consumer or be absorbed entirely by the latter. Such an option is chosen already by some sellers who ask for prepayment before shipping a product. Under this plan, the consumer bears the interest cost while reviewing the product's qualities. Other sellers ask for a deposit, in which case the interest cost is shared by the seller and buyer. Similarly, there are some circumstances in which consumers pay for shipping ("handling costs") and prepay for the product, but retain the right to return the good for a full refund of the product's price. But, for some consumers, the costs of shipping and repacking that are encountered may often exceed the costs of showrooms and retail relationships.

16. The terminology in the text does not imply any important difference between returns and warranties. As far as the free-rider problem is concerned, the two serve the same purpose. A warranty refers to the consumer's right to a refund if the product does not conform to a set of explicit and implicit promises about its characteristics. A liberal return policy is really nothing more than a warranty with a boundless list of promises, or simply a promise of customer satisfaction. The contract normally sets up a procedure for dealing with returns and complaints after the product has been used or otherwise diminished in value. For example, tire manufacturers promise long periods of satisfaction, but then measure tread wear in order to discount the refund amount. None of these variations on an absolute refund policy interfere with its role as a solution to the free-rider problem.

What is less apparent about an expanded "returnable" strategy is that it discriminates among consumers more than a retailer-based strategy does and that this discrimination may be quite efficient.[17] A retailer's costs generally are spread among all consumers. Under a vertical restriction, such as resale price maintenance, the retailer is forced to charge each consumer the same price for a given product. In fact, some consumers will subsidize the needs of others. Some buyers may experiment with different display models and test the product as much as possible in the showroom. Other buyers will not use much of the salespeople's time and do very little product testing. Yet, under a resale price maintenance program both types of buyers will pay the same price. The vertical restriction will raise the price of the goods beyond what some buyers are willing to pay, although the buyers are perfectly willing to pay more than the cost of production.[18] Presumably, a more flexible plan, dealing with the free-rider problem at the midstream level of the retailer, would be too expensive to administer and police.[19] The "returnable" strategy, however, allows

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17. For a thorough review of the effect of price discrimination on efficiency and income distribution, see F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 319-25 (2d ed. 1980).

18. This restates the proposition that vertical restrictions are inflexible. *See* note 6 *supra* and accompanying text.

One last attractive feature about these downstream solutions is that they avoid a still different free-rider problem. As a manufacturer tries to fashion an upstream solution or as retailers provide services under an allowable vertical restriction, there is the danger that one brand will get a free ride from the information provided about another brand. For example, one tire manufacturer may let another educate consumers about the advantage of radial construction and then take a free ride. Thus, even if vertical restrictions are to be per se legal, information will be undersupplied. The downstream solution offered by independent informers does not suffer from this imperfection, as long as one informer tests a variety of products and consumers are not asked to pay for general information when inquiring about a specific brand.

19. This comparison is best viewed as concerning the alternative methods for selling information to potential consumers. A vertical restriction, such as resale price maintenance or exclusive territorial assignments, eliminates price competition among retailers; the manufacturer expects that remaining retailers will encourage sales by providing nonexploitable information about the manufacturer's product. Generally, this approach yields a given amount of information; a higher resale price, for example, is likely to stimulate still more retailer-provided information (and lower sales).

A more "flexible plan" for the offering of information, *see* note 6 *supra*, attempts to respond to the varying informational needs of customers. No sale need be lost as a result of the higher price that accompanies a vertical restriction because consumers pay separately for information and products. In the extreme case, one consumer can buy a product, unseen, at a low price while another buys the product and pays hourly fees for showroom visits. As noted earlier, this sort of plan is better than a vertical restriction to the extent that separating information from products permits sensitivity to consumer demands. But it is far inferior to a vertical restriction to the extent that it generates formidable transacting costs.

Finally, as discussed in the text, a "returnable" strategy may be responsive to individual consumers' demands and, therefore, provide considerable flexibility because consumers will bear at least some shipping and interest costs. If these costs exceed the value discrimination among buyers, at least to the extent that shipping companies vary their rates according to distance. The Alaskan buyer who compares six brands of washers over a period of two weeks will pay for those shopping tastes in the form of deposits and shipping costs that will not be borne by the less particular consumer who lives at dockside. This result is more efficient because buyers command resources according to their willingness to pay.

The attraction of the "returnable" strategy should not cloud the infeasibility of this solution to the free-rider problem. Some buyers may have difficulty meeting shipping schedules. Rising energy costs may make individual deliveries unjustifiable. The important point is that courts need to evaluate a variety of downstream alternatives to retailer services, including independent informers and liberal return and warranty policies.

### B. *Downstream Informers*

The ability of traditional downstream informers, such as *Consumer Reports*, to solve the free-rider problem requires an investigation into the economic base and limitations of these institutions. Ironically, it would not be surprising if a different free-rider problem defeated this solution to the retailer-level free-rider problem. For example, if the downstream information is supported by magazine sales, it is in the interest of each user to wait for someone else to pay for the information and then to use the neighbor's or library's subscription. Some downstream information, such as that concerned with stock market trends, is apparently so sensitive to the passage of time that interested consumers feel compelled to subscribe rather than share newsletters over the weekend. But few consumers are in a rush to buy televisions and washers. It seems that the number of customers who prefer to have the information in hand is sufficient to support a number of downstream informers. For a few goods, such as automobiles and restaurant meals, the number of downstream evaluators is substantial. If the downstream free-rider problem could be overcome by having each consumer pay for each iota of information received, there surely would be far more downstream informers. To the extent that more competition among downstream informers would stimulate demand for an industry's output as a whole or for a particular manufacturer's product, one might expect manufacturers to avoid the midstream free-rider problem, not only by paying retailers for particular services, but also by paying downstream informers to judge the various products and report their results.

A manufacturer with something unique to offer may realize that con-

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of the information obtained, then, of course, this strategy will be unsuccessful, for consumers will not inspect the goods as offered. But to the extent that the transacting costs of the "returnable" or "flexible plan" are less than the value of the obtained information to consumers, either of these plans can be more efficient than a vertical restriction, which by itself makes no attempt to differentiate among consumers' demands for information.

sumers will be skeptical about claims and evaluations that emanate from the manufacturer and may, therefore, be willing to pay other parties to discover this information and relay it to potential consumers. A familiar example of this phenomenon concerns the practices of some publishers, theaters, and restaurants in supplying free products to reviewers. In some cases the seller can vary its product over the range of customers, and a purposefully supplied sample is less reliable than one that is anonymously purchased.[20] The underlying point, of course, is that any concern with the free-rider problem at the retailer level and any preference for vertical restrictions logically ought to be matched by concern for the free-rider problem among consumers farther downstream. Restrictions at this level could amount to censorship, such as forbidden library acquisitions, and would seem to be entirely inappropriate.[21] On the other hand, the possibility of taxing or otherwise encouraging manufacturers or consumers to finance independent evaluations of products should not be dismissed. Unless the few downstream informers supported by subscribers somehow provide sufficient information compared with the amount that would be produced in the absence of this downstream free-rider problem, the market may require some corrective intervention. In other areas, however, such as the rating of corporate bonds, the free-rider problem is less severe because timeliness is more critical and customers have some difficulty identifying one another; but the free-rider problem remains severe in the case of information about less time-sensitive goods.

## IV. CONCLUSION

The literature and cases dealing with vertical restrictions in distribution have concentrated on the free-rider potential among retailers. In the absence of a vertical restriction such as resale price maintenance or territorial exclusivity, a dealer can sell to customers who have taken advantage of a competitor's services and information. But the law equivocates in approving these vertical restrictions, however useful they may be in solving the free-rider problem, because they may support manufacturer or retailer cartels.

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20. That many downstream informers, such as car magazines and travel agents, review free samples does not necessarily taint their conclusions. In some cases the evaluator gets free samples from competing producers and is not, therefore, immediately beholden to any one provider. Moreover, many of these sellers cannot vary their products and provide particularly good ones to reviewers. This is especially true of mass-produced goods and of services that can be widely observed by an evaluator regardless of the quality of the individualized service received from the attentive producer.

21. To some extent, the law already deals with this downstream free-rider problem by forbidding manufacturers to advertise the ratings that have been earned in *Consumer Reports*. On the other hand, restaurants regularly post the best reviews in their windows. Even if the manufacturer or seller is completely stopped from appropriating the downstream informer's findings so that some consumers must buy the test results themselves, consumers can still free-ride on libraries' and each other's subscriptions.

Commentators have noted both the difficulty inherent in maintaining a cartel and the need to solve the free-rider problem. A standard has been proposed under which vertical restrictions actually would be per se legal; cartels would be attacked on the basis of their illegal horizontal arrangements rather than by mere identification of ambiguous vertical restrictions. But it is difficult and costly to identify collusive horizontal agreements. Moreover, these commentators have missed the potential of "downstream" solutions to the free-rider problem they seek to solve.

At a less theoretical level, the issues discussed in this Essay bear on current antitrust law. Courts continue to treat resale price maintenance as per se illegal and other vertical restrictions as governed by the Rule of Reason. Many commentators have argued for an end to this distinction and urged judicial deference to manufacturers' marketing strategies. The discussion in this Essay has indicated that it would be most appropriate for the courts to begin with a more accepting treatment of restrictions that concern products least susceptible to downstream solutions. In these cases it is most likely that a vertical restriction, including resale price maintenance, is necessary to overcome the free-rider problem at the retailer level.

This Essay has identified a variety of solutions to the free-rider problem. The success of any one of these obviates the need to permit vertical restrictions. In the face of free riders, the manufacturer itself may be able to provide information or contract directly for retailer services. Most important, insofar as some products are concerned, there may be workable downstream solutions to the free-rider problem; independent testing institutions may produce superior information. Manufacturers may be able to avoid retailers entirely by allowing consumers to inspect the product and return the good if not satisfied; the marketing decision then concerns the allocation of interest and shipping costs.

Examination of these downstream alternatives reveals novel issues. On the positive side, a downstream solution may discriminate among purchasers more efficiently than retailer-provided services. On the other hand, some downstream solutions may suffer from a unique free-rider problem that derives from the public-good quality of information. The Rule of Reason needs to be applied within a framework that reflects the various downstream solutions. The free-rider problem can be solved in a surprising variety of ways and a fair inquiry should consider the alternatives before sanctioning one ambiguous solution.