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Maximum Price Fixing

Frank H. Easterbrook†

If all of the grocers in a city agreed to sell 100-watt light bulbs for no more than fifty cents, that would be maximum price fixing. If a group of optometrists agreed to charge no more than $30 for an eye examination and to display a distinctive symbol on the shops of parties to the agreement, that would be maximum price fixing. And if most of the physicians in a city, acting through a nonprofit association, offered to treat patients for no more than a given price if insurance companies would agree to pay the fee, that agreement would be maximum price fixing too.

A maximum price appears to be a boon for consumers. The optometrists’ symbol, for example, helps consumers find low-cost suppliers of the service. But the agreement also appears to run afoul of the rule against price fixing, under which “a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity . . . is illegal per se.”¹

This rule might be read as banning only those price agreements that reduce the allocative efficiency of the economy: monopolistic price increases and monopsonistic price decreases. In either of these cases, a price agreement drives a wedge between the competitive price and the market price, to the detriment of efficiency. On the other hand, if a maximum price agreement serves only to supply information to consumers about where bargains can be had, or to overcome conditions that have elevated price above marginal cost, the objections to monopoly and monopsony do not apply.

The Supreme Court has been of two minds about arguments of this sort. On the one hand, it has said that the benefits of price agreements are irrelevant. “Whatever economic justification particular price-fixing agreements may be thought to have, the law does

† Professor of Law, University of Chicago. I thank Douglas G. Baird, Dennis W. Carlton, Kenneth W. Dam, William M. Landes, Phil C. Neal, B. Peter Pashigian, Richard A. Posner, Stephen M. Shapiro, and George J. Stigler for their helpful comments on an earlier draft.

¹ United States v. Socony-Vacuum Oil Co. (Madison Oil), 310 U.S. 150, 223 (1940).
not permit an inquiry into reasonableness. They are all banned because of their actual or potential threat to the central nervous system of the economy." It has applied this rationale to hold maximum price agreements unlawful in *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.* and *Albrecht v. Herald Co.* At the same time, the Court regularly sustains business ventures that engage in price fixing far more successfully than any cartel. Mergers, joint ventures, partnerships, and similar organizations suppress price competition internally to organize production through other means. These arrangements could be banned as price fixing, but they are not. To call something "price fixing" therefore does not assist in analysis; "price fixing" is no more than a label given to arrangements that have been found unlawful per se. It is necessary to examine a given arrangement's probable effects before attaching this fatal label. The Court has been willing in recent years to conduct such examinations to determine which arrangements are most beneficial to consumers. I argue in this article that maximum price fixing is almost always beneficial to consumers and that the time has come to abandon any per se rule against the practice.

I. *Kiefer-Stewart and Albrecht*

The examples of maximum price fixing given in the first paragraph of this article involved cooperation among competitors. Both of the Court's decisions on maximum price fixing, however, involved vertical restrictions: resale price maintenance. In *Kiefer-Stewart* two affiliated liquor distillers insisted that their wholesale customers reduce the price at which liquor was furnished to retailers. In *Albrecht* a newspaper insisted that its distributor reduce the price charged to subscribers. The distillers and the newspaper were buying distribution services, and the cost of distribution was

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*Id. at 226 n.59. See also Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 647-48 (1980).*

*340 U.S. 211 (1951).*

*390 U.S. 145 (1968).*

*Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1, 9 (1979); Abadir & Co. v. First Mississippi Corp., 651 F.2d 422, 426 (5th Cir. 1981).*

the difference between the initial price and the "fixed" resale price. It is possible to see both cases as monopsony problems, with the seller attempting to monopsonize distribution; it is possible, too, to interpret the cases as boycotts, subject to scrutiny accordingly. Horizontal maximum price fixing does not involve either of these problems.

It is unnecessary, however, to hunt for strained distinctions to argue that *Kiefer-Stewart* and *Albrecht* should not be controlling in maximum price fixing cases. Both cases invoked rationales that have since been repudiated by the Court. *Kiefer-Stewart* disposed of the antitrust arguments laconically, stating that maximum price agreements, "no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment."8 *Albrecht* repeated this theme.9 But the "freedom of traders" has nothing to do with consumers' welfare. The emphasis on "freedom of traders" in these cases recalls the remark of the Court in the *Schwinn* case that restricted distribution practices limit "the retailer's freedom as to where and to whom it will resell the products"10 and so "violate the ancient rule against restraints on alienation."11 The Supreme Court has overruled *Schwinn* and explicitly rejected any analysis that makes antitrust cases turn on the "autonomy of independent businessmen."12 Arguments about the effect of a practice on quantity and price, not arguments about freedom and autonomy, control antitrust analysis.

*Kiefer-Stewart* contains no arguments about price or quantity. *Albrecht* does. The *Albrecht* Court asserted that maximum price agreements substitute "the perhaps erroneous judgment of the seller for the forces of the competitive market" and thus reduce "the ability of buyers to compete and survive in that market."13

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7 Although such interpretations are possible, they are not plausible. The sellers have no incentive to monopsonize distribution, for that just dries up the supply of distributors and prevents the seller from disseminating its product. Moreover, the characterization of the acts as "boycotts" does not help us to decide whether the maximum price fixing is desirable.

8 340 U.S. at 213.
9 390 U.S. at 152.
11 390 U.S. at 152.
12 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 53 n.21 (1977). Justice White, the author of *Albrecht*, objected to this aspect of the *GTE Sylvania* decision, calling it inconsistent with *Albrecht*. Id. at 66-70 (White, J., concurring).
13 390 U.S. at 152. See also id. at 153 ("[M]aximum price fixing may channel distribution through a few large or specifically advantaged dealers"—apparently describing dealers
This is really two arguments. First, it asserts that sellers may err in establishing a price. This is irrelevant to antitrust policy; a single firm also may err in setting its own price, but this has never been thought to call for condemnation, even when the error-prone firm is a monopolist. Because the market penalizes errors, firms eventually will correct their mistakes or suffer the consequences. The second argument concerns the effect on buyers and reflects solicitude for competitors, as distinct from competition. This approach is no more helpful in evaluating the practice than is solicitude for the freedom of traders.\footnote{See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (Sherman Act protects “competition, not competitors”)} The only argument in Albrecht that concerns competition is the assertion that the maximum price soon will become the minimum price, and then the arrangement will acquire the defects of a cartel.\footnote{See Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 649 (1980) (per se rule applies if “a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value”); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 n.16 (1977) (in establishing per se rules, “[t]he probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against its procompetitive consequences. . . . [A] per se rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them”).} Perhaps so; I consider this possibility in part III-A. But the Albrecht opinion simply asserts the conclusion. It provides no argument that this is likely or, if likely, undesirable.

The shallowness of the reasoning in Albrecht suggests that its rule should be examined more closely. The Court has emphasized in recent years that per se rules should be employed only after thorough study and considerable experience have led to a conclusion that almost every instance of the practice sought to be condemned is harmful, so that there is no point in attempting to separate the harmful instances from the harmless or beneficial ones in case after case.\footnote{See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1, 9-10, 19 & n.33, 22 n.40 (1979) (emphasizing need for “considerable” experience with a practice before per se condemnation and remarking on role of output reduction as trigger for a per se rule); National Soc’y of Professional Eng’rs v. United States, 435 U.S. 679, 692-93 (1978) (per se rule applies only to agreements “whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed”); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 n.16 (1977) (in establishing per se rules, “[t]he probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against its procompetitive consequences. . . . [A] per se rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them”).} Per se rules are used, in other words, to hold as low as possible the sum of the welfare losses from the practice and the costs of litigating about it.\footnote{See Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 333-37 (1981); Posner, The Next Step in the Antitrust Treatment of Restricted Dis-
rule unless the Court is confident that "the effect and . . . because it tends to show effect, . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy—that is, [that] the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, . . . or instead one designed to 'increase economic efficiency and render markets more, rather than less, competitive.' "

The Court never has attempted to determine whether maximum price fixing almost always would "tend to restrict competition and decrease output" or "increase economic efficiency" instead. Just as Schwinn was not the last word on restricted distribution practices, so Albrecht cannot be the last word on maximum price fixing. To explore the uses of maximum price fixing, I concentrate in this article on agreements among competitors, disregarding vertical restricted distribution arrangements. If such horizontal agreements have benefits that make application of a per se rule inappropriate, restricted distribution cases can be disposed of without further ado.

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19 The Court has hinted that Albrecht is open for reexamination. See Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 210 & n.5 (1979) (reserving judgment on the legality of an agreement to set maximum prices).

20 Maximum resale price fixing has none of the potential anticompetitive consequences of horizontal maximum price fixing (see part III, infra), and so the vertical case can be resolved more easily. Moreover, maximum resale price fixing has a competitive benefit that does not occur in cases of horizontal maximum price fixing: the maximum resale price prevents distributors from exploiting territories given to them by manufacturers. Distributors with exclusive territories may attempt to set monopoly prices; maximum resale price maintenance prevents this. Because it is lawful to grant exclusive territories, it also should be lawful to place on the grant such conditions as are reasonably likely to aid consumers. These and other arguments about maximum resale price fixing have been made cogently elsewhere, and there is little point in repeating the analysis here. See Albrecht v. Herald Co., 390 U.S. 145, 165-68 (Harlan, J., dissenting), 168-70 (Stewart, J., dissenting) (1968); 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 734e (1978); R. BORK, supra note 6, at 435-39; R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 158 (1976). See also Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883, 885-86 (1st Cir.), cert. denied, 439 U.S. 833 (1978), for a convincing argument that resale price fixing is not unlawful, even under Albrecht, when used as an ancillary device to implement territorial allocations.
II. FUNCTIONS OF MAXIMUM PRICE FIXING

A. Introduction

In perfect competition firms sell at marginal cost—as low as the most efficient method of production will allow. An agreement to charge a maximum price lower than marginal cost would cause a reduction in allocative efficiency. Such a possibility is of little legal interest, however, because firms usually can be counted on to protect their own interests. If price falls below marginal cost, they can make more money by increasing price. An agreement calling for sales at less than marginal cost consequently would be unstable. Firms would raise prices as soon as they discovered the error. There is no reason for antitrust law to penalize blunders of this sort; the firms bear as private losses any damage done by their prices, and blunders thus are self-deterring.¹

A maximum price agreement could be a conspiracy to charge a predatory price, but here too there is no reason for concern. Predation does not work unless the predator, having driven rivals from the market, can raise its price and recoup its investment in predation through monopoly overcharges. A “conspiracy to predate” through maximum prices would be absurd. Even if the predators—the firms subscribing to the maximum price agreement—could drive rivals from the market, they could not recoup their investment. The participants in the price reduction agreement would begin to compete against one another once price rose. Only a minimum price fixing agreement, a cartel, would make recoupment possible. But such a cartel could be detected and prosecuted under standard antitrust rules, and the damages award would prevent the conspirators from recouping. There is no reason to proceed against a maximum price agreement that has not produced—and probably never could produce—a recoupment cartel.²

There are thus only two cases about which we must be concerned. It is possible that the maximum price agreement is a disguise for a more traditional cartel, in which event the agreement should be held unlawful. It is also possible that without the agreement, price would exceed marginal cost; the maximum price agreement then drives price back toward marginal cost or, perhaps,

¹ See Easterbrook, supra note 17, at 278-81, for a more complete explanation of why prices at less than marginal cost are self-deterring.

² See id. at 331-33 for an argument that only a person who pays the overcharge should be permitted to bring a predatory pricing suit.
reduces marginal cost. If a maximum price agreement has either effect, we should count ourselves fortunate; condemnation is out of the question. But at least at first glance, it is hard to see why sellers who can obtain a price exceeding marginal cost would agree to charge less, or how sellers can reduce their costs by acting collectively. If sellers have no plausible—that is, profitable—reason for reducing their prices, we may infer that any given maximum price agreement is actually a traditional cartel in disguise. To understand the function of a maximum price agreement, then, we must ask how firms can profit by reducing price.

B. Searching for Low-Price Sellers

One important discovery of the economics of information is that the cost of searching for low-price sellers affects the price sellers will charge. The more costly the search, the more likely it is that any given seller will be able to set a price exceeding marginal cost. When a buyer does not know what price each seller charges, he must go from seller to seller seeking information. Every visit entails a cost: the searcher's own time is valuable, transportation is costly, and delay in making the purchase also may be costly. Sellers can take advantage of this. If, for example, the marginal cost of a widget is $100, and a prospective searcher incurs a cost of $5 to learn the price at any store, the merchant can set a price of at least $105 for his widget, if he knows consumers' search costs. Even if the consumer knows that widgets are available somewhere for $100, he would pay $105 if that were the price at the first store he visited. If he refused the offer, he would incur a cost of $5 to make another check and even then might not get a quote of $100. If every seller is charging $105, none has an incentive to reduce the price to $100, because the reduction would not generate additional business. (Every buyer visits only one store.) If search costs fall, however, so does the price.

Not all buyers have the same search costs. Those with lower costs will look at more than one price. These searchers enable some merchants to increase their volume by reducing prices; low-cost searchers might keep trying until they found widgets for $102, and stores that reduced price to this level might experience an increase in sales that more than offsets the lower per-sale profit. In a sense,

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these low-cost shoppers protect the high-cost shoppers. If substantial numbers of people do not do much searching, however, many sellers will find it advantageous to set a price above marginal cost.24

Advertisements are one way low-price sellers can identify themselves. The Supreme Court has recognized what studies show: advertising leads to lower prices by reducing the cost of finding low-price sellers.25 Advertisements are less effective in reducing price, however, if buyers are uncertain about the quality of the product (the advertised price might represent just an inferior sample) and if the seller who advertises cannot expand his output (much) at the low price. In the latter case the advertising sellers will not draw much business from the quiet sellers, who can continue to charge a price exceeding marginal cost. Moreover, if a third party and not the searcher pays for the product, price advertising may be pointless. The rational consumer, assured of third-party payment, will ignore the advertisements and go to the seller who offers the highest quality, or perhaps simply to the first seller. We therefore would expect significant price dispersion and many sales at prices exceeding marginal cost whenever search is costly or infrequent, quality uncertain, and the consumer does not pay for the purchase.26

24 This principle was exploited by the defendants in National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679 (1978). The society adopted a rule prohibiting competitive bids. Purchasers of engineering services consequently had to go from engineer to engineer, seeking a price from each one in sequence. Because each engineer might take weeks or months to examine the specifications and submit a price, the cost of each search was high. The society admitted, and the Court assumed, that this strategy raised prices. Justice Blackmun explicitly observed that the costs of searching were the cause of the higher prices. Id. at 700 (Blackmun, J., concurring).


A maximum price agreement can help to reduce search costs. Sellers would find the maximum price useful for the same reason they find advertising useful. Those adhering to the agreement are identified as low-price sellers, and this identification should lead to an increase in the sales by those so identified. Maximum (list) prices are used this way by many manufacturers and dealers. This benefit is sufficiently plain that even the Antitrust Division of the Justice Department has pointed to it as a justification for a maximum price agreement.27

These principles are quite abstract, so it may be helpful to apply them to an existing maximum price agreement. The Maricopa Foundation for Medical Care is a nonprofit association that acts as agent for both physicians and insurance companies. Any physician in Maricopa County may join; approximately seventy percent have done so. The foundation proposes maximum prices for medical services. In exchange for the insurers’ agreement to pay the price for services, the member physicians undertake not to seek any additional payment from the patients. In Arizona v. Maricopa County Medical Society,28 the Ninth Circuit held that this arrangement is not unlawful per se as price fixing.

Medical services are a textbook example of goods in which quality is uncertain, search costs are high (patients sometimes cannot search at all), purchases are infrequent, and third-party payments reduce the incentive for patients to search even when they can do so at low cost. A maximum price agreement may identify low-price sellers to the insurance companies, which may instruct the insureds to use a member of the foundation for medical care. Insurers participating in the plan will have lower costs, and the insureds will pay lower premiums. Physicians willing to accept the established maximum may join the foundation; others will not do so. The process should lead to a reduction in the cost of service, satisfying the criteria set out in the introduction to this part of the

27 Brief for the United States as Amicus Curiae at 10-14, Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979) (A maximum price agreement “help[s] the policyholders find low-overhead pharmacies with which to deal. Moreover, it provides pharmacies with incentives to reduce their distribution costs in order to be able to take advantage of [the maximum price] and still make a profit.” Id. at 11-12). Group Life involved a maximum price schedule announced by an agent representing thousands of buyers of services; in part III-A, I consider whether sellers’ agreements should be treated differently.

28 643 F.2d 553 (9th Cir. 1980), cert. granted, 101 S. Ct. 1512 (1981) (No. 80-419). The stated facts appear in the opinion with one exception: the seventy percent membership estimate is in the appellate record at 7(a) & 106.
article: the maximum price agreement makes both consumers and the participating sellers better off. I consider in part III whether there is a more sinister explanation for medical foundations of this sort.29

C. Reducing Transactions Costs

In some markets the costs of striking an agreement may be very high in relation to the value of the good. The market in musical performing rights is an example. Radio and television stations play thousands of copyrighted songs and jingles daily, sometimes not deciding what to play until moments before airtime. The market would break down if a license had to be negotiated for each use. The costs of negotiation would be substantial, the costs of delay or advance planning large, and the costs of composers' listening to every program to ensure that no unlicensed music was used incalculable. Composers therefore have formed performing rights societies, which grant "blanket" licenses to users of music. The blanket licenses are price fixing in a technical sense—the competing copyright holders agree on a price for the license and divide the proceeds—but the agreement unquestionably increases allocative efficiency. The societies cannot charge more for the license than the license and transactions costs that would be incurred by the users if they obtained individual licenses. The users' preference for blanket licenses establishes that they are beneficial, and the Su-
The Supreme Court has held that they are not unlawful per se despite the existence of price fixing.\(^3^0\)

Performing rights licenses are an extreme case, but the principle is perfectly general. Cooperative behavior often reduces costs. The cooperation in a legal partnership or a corporation is an example. Maximum price agreements may be another. In the example of the optometrists given at the beginning of this article, the maximum price agreement served as a basis for price advertising (through the distinctive symbol), and such advertising may be less costly and more effective than advertisements placed by many individual optometrists.

The same can be said of the maximum price agreement in \textit{Maricopa}. Consider the costs of reaching price agreements in every case. Consumers must take on faith much of what their physicians tell them, and it is often hard for physicians even to describe their product. Patients would have to educate themselves to a considerable degree to know what they should be willing to pay for a given service. The physician, as well as the consumer, may be ignorant of the relevant costs and benefits of service. Young physicians in particular would not know appropriate charges.\(^3^1\) They could, of course, pick prices arbitrarily and see how many patients refused treatment; patients in turn could attempt to learn something about medicine and seek quotes from several physicians. But the costs of such a trial-and-error process would be high.

There is, moreover, a need for emergency service. Patients may be unconscious or in no position to negotiate. Or after treatment begins, it may become clear that the case is more complicated than the parties first supposed. If the physician first renders service and then attempts to name a price, the parties are locked


\(^3^1\) See Eisenberg, \textit{Information Exchange Among Competitors: The Issue of Relative Value Scales for Physicians' Services}, 23 J.L. & Econ. 441 (1980), for a description of the problems in setting prices for medical services. The costs of price-setting by individual physicians are especially high if, as sometimes occurs, the physicians attempt to size up their patients and charge more to the wealthier. \textit{See Kessel, Price Discrimination in Medicine}, 1 J.L. & Econ. 20 (1958).
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into a bilateral monopoly; the physician will name a high price and the patient a low one, and because the service has been performed, neither has much incentive to compromise. Although the law of restitution supplies an off-the-shelf answer to this impasse, it may be quite costly to apply the legal principles. A price schedule that allows instantaneous service is one of the benefits of performing rights societies, and this holds for maximum price fixing as well.

When third parties such as insurance companies pay for the service, the transactions costs of reaching a price agreement become especially high. The insured person has no reason to seek low-price suppliers. Instead, he will seek the highest quality supplier for which the insurer will pay. The insurer must attempt to police price agreements between patient and physician. It may limit fees to customary charges for average-quality providers, investigate bills to determine whether the service was warranted, and so forth. But these measures are costly and apt to be ineffective. Once the service has been performed, the professional (whether physician or auto-body rebuilder) has control of the relevant information and can plausibly insist that the service was necessary and the fee justified by the complexity of the task. The adoption of a maximum fee schedule reduces these costs of supervision. The insurer can offer lower rates, and the providers can save the hours they used to spend filling out forms justifying the service and fees. The fees earned during these released hours easily could compensate for the lower fee per treatment, making the maximum price schedule profitable to all parties.

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32 Even the process of searching for high quality sellers may be inefficient. The developing economics of signaling suggests that sellers attempt to send "signals" about the quality of their wares, and that the signaling is wasteful because it is offset by other resources. See, e.g., Hirshleifer & Riley, The Analytics of Uncertainty and Information—An Expository Survey, 17 J. ECON. LITERATURE 1375, 1389-91 (1979) (collecting sources). Markets often develop methods to suppress wasteful signaling and inefficient sorting. See Barzel, Some Fallacies in the Interpretation of Information Costs, 20 J.L. & Econ. 291, 301-05 (1977). Maximum price agreements may serve such a function. Suppliers who cannot send signals that identify their quality at low cost would join the maximum price group, which can reduce its price by the saved signaling costs; suppliers who can identify their quality at lower cost will stay out of the group and sell a distinctive product at a different price.

It might seem that the cost reductions come from the existence of any fee schedule and are not specific to maximum price fixing by suppliers. Insurance companies would be an alternate source of price schedules. Insurers, however, do not necessarily have as much information as suppliers’ groups about the relative costs and difficulties of particular services. Schedules promulgated by the insurers therefore are less likely to clear the market. Moreover, maximum price schedules adopted by associations of providers require fewer total transactions. Once the association adopts a maximum price schedule, each provider and each insurer must make a single decision: whether to participate in the program. A single identifier (for example, “Member of the Maricopa Foundation for Medical Care”) can inform the insureds under many plans whether the provider has agreed to accept the insurer’s payment in satisfaction of the fee. If each insurer must promulgate its own schedule, however, every provider must accept or decline the offer from every insurer; the number of transactions equals the number of sellers times the number of insurance plans.\(^3\)

The costs of buyer-proposed schedules could be less than the costs under seller-proposed schedules. When that is so, we would observe buyers proposing their schedules and attracting business. That occurred in *Group Life & Health Insurance Co. v. Royal Drug Co.*,\(^3\) where Blue Shield proposed a price schedule for prescription drugs and enrolled all pharmacies that would dispense drugs for cost plus a fee of $2. Insurance companies have proposed schedules for auto-body repair as well. But when sellers propose a maximum price schedule and buyers do not make a counteroffer, it is fair to conclude that transactions costs are lower under the sellers’ schedule. These savings are quite similar to the cost reductions that led the Supreme Court to conclude in *Broadcast Music* that performing rights societies are not unlawful per se despite the composers’ plain agreement on price.

D. Creating a “New Product”

Price reductions associated with lower search and transactions costs may well accompany any maximum price agreement. Only

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\(^3\) The number of transactions could be reduced if the insurers cooperated in proposing fee schedules. That, however, would substitute buyers' cooperation for sellers'. There is no reason to prefer potential monopsony (buyers' cooperation) to potential monopoly (sellers' cooperation).

\(^3\) 440 U.S. 205 (1979).
the magnitude of these effects will vary from product to product. Additional savings may be available under unusual circumstances.

In dealing with the price agreements underlying performing rights societies, the Court observed that the blanket license is a distinctive product: it allows users both great flexibility in choosing compositions and the ability to play compositions without delay. This recognition that the blanket license offers a new product, one not available without cooperation among copyright holders, was an element in the Court's conclusion that the blanket license was not unlawful as price fixing.

A maximum price agreement, like the blanket license, changes the identity of the "product" in at least some cases. The Maricopa case again provides an example. When consumers purchase health insurance, they obtain protection against at least two kinds of uncertainty: whether they will need medical assistance and the cost of the assistance. Some cases will be more difficult than others. The insurance company usually assumes both risks, but this may not always be desirable. If the insurer will pay for any treatment, however costly, physicians have an incentive to provide unwarranted service. The lack of price discipline creates a moral hazard and leads to excessive costs.

The moral hazard can be reduced if the physician insures part of the uncertainty. If the physician's fee for described courses of treatment is fixed, he loses any incentive to provide unwarranted care. When the treatment turns out to be more simple than anticipated, the fixed fee overcompensates the physician for his time; when the case is unusual or complications develop, the maximum fee undercompensates the physician. Spreading the risk in this fashion over thousands of cases is the usual definition of insurance. Without a maximum price, however, this method of in-
surance by physicians—even if desirable because it reduces costs—would not work as well. An individual physician who announced a maximum price would find patients with more complex cases more likely to come to him. Patients with simple cases would go to physicians who charged by the hour rather than by the treatment. In the end, the physician would be compelled to raise his fixed price until it equaled the expected fee for the most complex treatments, and the benefits of insurance-by-providers would be lost. A maximum price agreement among a substantial number of providers overcomes this sifting mechanism and preserves the benefits of this insurance device.

III. ANTICOMPETITIVE EXPLANATIONS OF MAXIMUM PRICE FIXING

I have discussed three ways in which maximum price fixing could benefit both producers and consumers. These benefits do not always accompany every maximum price, because a maximum price agreement might simply be a euphemism for a cartel price. In the following sections, I discuss some of the less pleasant characterizations of maximum price fixing and how beneficial agreements may be distinguished from others.

A. Cartels

One way to argue that maximum price agreements are like cartels is to say that the maximum price will become the minimum price. If the ceiling is a floor, the argument runs, there is no difference between the two. The Supreme Court in Albrecht and the dissenting judge in Maricopa made arguments of this sort.

The analogy is not helpful. Although it is true that if the seller discovers that consumers will pay the maximum price, he will charge that price, this tells us little of interest. The seller will charge what the traffic will bear whether or not he participates in an agreement. The pertinent question is whether the agreement

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41 390 U.S. at 153.
42 643 F.2d at 567-68 (Larson, J., dissenting).
43 Moreover, the traffic will not always bear the maximum price. Even when third parties pay most of the cost of medical care, for example, the patient may be required to pay some portion of the expense. These copayments will induce the patient to shop for bargains.
enables the seller to charge more than he could obtain without the agreement. The argument that the maximum price becomes the minimum price does not answer this question. Unless it raises price, the agreement is either harmless or beneficial.

Sometimes the source of savings from maximum prices is the identity between maximum and minimum price. The example in part II-D illustrating how maximum prices enable suppliers to become insurers shows this principle at work. The equation between maximum and actual price also accounts for any reduction in search costs. To say that the maximum price becomes the minimum may be to praise the arrangement, not to criticize it.

It is necessary, therefore, to ask more directly whether the maximum price agreement displays the reduced output and higher price characteristics of a cartel. The per se rule is of no help here because it avoids any questions concerning the effects of the agreement. The appropriate method is the one used in Broadcast Music. If an examination of the practice gives sound reasons for thinking that significant efficiencies of the sort described in part II are at work, a more detailed inquiry is necessary. If such efficiencies are absent, the arrangement should be found unlawful per se to avoid the large litigation costs of searching for small efficiency gains.

An inquiry under the Rule of Reason, however, should not be unduly complex in maximum price fixing cases. At least in principle, there is an easy test. The court could determine whether the quantity supplied was higher in markets with maximum price

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In addition, once a price has been set, the consumer will search for higher quality. Low-quality sellers must offer price concessions to obtain business. To equalize quality, younger, less-experienced physicians would work for less, work under the supervision of another physician (who would keep part of the fee), or spend more time on each case.

44 441 U.S. at 8-9, 19-20.

45 The qualification—"significant" efficiencies—is important. Any cartel will reduce search costs if it is enforced. (There may be offsetting increases in cost as cartelists attempt to prevent price cheating by other firms.) Cartels may stabilize sales and improve the quality of information. Under some circumstances the long run gains of these savings could exceed the allocative losses. See Dewey, Information, Entry, and Welfare: The Case for Collusion, 69 AM. ECON. REV. 587 (1979). But antitrust law frequently disregards savings of this sort, because the conditions necessary to make cartels beneficial include free entry and other criteria unlikely to prevail in practice; the short term losses almost certainly exceed the speculative long term gains. For the same reason that we ignore information cost justifications for cartels, we should disregard insubstantial efficiencies achievable by maximum price fixing.

fixing than in markets without. Such a direct comparison, which may be possible with the aid of econometric tools, answers the central question about cartels.

If it is not possible to determine whether the agreement led to an increase in output, it becomes necessary to resort to second-best devices. The theory of cartels advanced by George Stigler and elaborated by Richard Posner provides a starting point for the inquiry. Posner has developed a list of indicia that often distinguish cartels from competition when direct inquiries ("Did they sign an agreement in a smoke-filled room?") are not helpful.

There is no need to recite those criteria here. Several inquiries, however, hold out special promise of utility in maximum price agreement cases. It seems most unlikely that a maximum price agreement is a disguised cartel if the sellers' market is not concentrated. Because it is costly to reach a cartel agreement, and even more costly to detect and punish cheating, markets with many sellers cannot easily be cartelized. It always will be in the interest of some sellers to break with the cartel, reduce prices, and so claim a greater share of the business. When there are several large buyers, this cheating could be especially profitable, because the seller can increase his business dramatically by appealing to a single substantial buyer. Buyers have every incentive to encourage cheating by funneling business to sellers who will reduce price. Considerations of this sort indicate that maximum price fixing rarely will be a cartel in disguise. It occurs in service industries such as optometry, retail sales, auto repair, and medical care in which there are hundreds of sellers and in which insurance companies can funnel business to sellers who shave prices.

Some other inquiries also should help to separate cartels from efficiency-increasing maximum price agreements. If the market share of the sellers participating in the agreement is small, they would not have sufficient market power to affect price, and a cartel

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48 See Fisher, Multiple Regression in Legal Proceedings, 80 COLUM. L. REV. 702 (1980). Econometric analysis requires, however, substantial data that may be difficult or impossible to obtain in particular cases.

explanation thus is unlikely. If the market share of the participants is growing, this indicates that the participants in the plan are not reducing output and so cannot be cartelizing. No cartel can profit by admitting all comers and doing nothing to halt an increase in output by its members. The behavior of buyers also provides valuable evidence. If buyers readily cooperate in a maximum price arrangement, they must perceive it to be beneficial; if, on the other hand, large buyers and insurers begin sending orders and insureds to sellers outside the agreement, this would suggest the existence of a cartel. Finally, we could attempt to make a direct price comparison. Is the price of participants in the maximum price arrangement lower than the price of nonmembers? The answer to this inquiry could be of ambiguous import—lower prices may be associated with lower quality—but it is suggestive.50

At least two inquiries, however, would be pointless. Little can be learned by asking whether sellers or buyers initiated the maximum price arrangement. As I have explained, buyer initiation may be more costly. Maximum price proposals by individual buyers are not maximum price fixing at all, and such proposals by groups of buyers (perhaps acting through insurers) simply substitute the possibility of monopsony for the possibility of monopoly.51 Neither should be preferred to the other.

We also learn little from whether the maximum price arrangement affects the number of suppliers. A cartel often attracts a fringe of small, inefficient suppliers that prosper only because the cartel price is higher than the more efficient firms' cost of production. A reduction in the number of suppliers thus may accompany the restoration of competition in a market. But it does not follow that the opening of many new, small firms shows that a cartel is at work. A new arrangement such as a maximum price agreement

50 In the Maricopa case these inquiries indicate that the maximum price arrangement is not a cartel in disguise. The market share of the medical foundations appears to be large and growing; insurers have participated in the program and do not, apparently, seek to direct their patients to physicians who do not belong. The price charged in the program is the same as or lower than the bills submitted by "eighty-five to ninety-five percent of physicians in Maricopa County." 643 F.2d at 555.

51 There is therefore no basis for distinguishing a case like Maricopa from a case like Royal Drug. In Royal Drug, Blue Shield proposed a prescription drug price of cost plus a dispensing fee of $2. 440 U.S. at 209. Blue Shield was acting as agent for the policyholders, just as in Maricopa the foundations were acting as agents of physicians. See Medical Arts Pharmacy of Stamford, Inc. v. Blue Cross & Blue Shield of Connecticut, Inc., 518 F. Supp. 1100 (D. Conn. 1981), which rejects antitrust challenges to agreements of the Royal Drug variety.
could make it possible for new suppliers to compete more effectively with established firms.\textsuperscript{52} A reduction in the number of suppliers could occur just as easily. Perhaps the price schedule has made each existing supplier more efficient—for example, the physician who is able to see more patients when he stops filling out as many forms—so that output rises even as the number of sellers falls. A Rule of Reason inquiry therefore should disregard changes in the number of suppliers.

B. Monopsony

If the buyers’ side of the market is concentrated and the sellers’ side unconcentrated, it is possible that maximum price fixing is a consequence of monopsony. The inquiries suggested above could be used to detect monopsony as well as monopoly. A price decrease coupled with a declining output would mark the onset of monopsony.

Monopsony is inconceivable in most cases. The optometrists or General Motors dealers who band together to advertise a maximum price are not reaching out to subject themselves to monopsony. Even when the buyers’ market is concentrated, a monopsony explanation usually is implausible. In the case of physicians’ maximum fee schedules, for instance, the insurance companies have no way to make a monopsony work. To depress prices they must curtail purchases; the purchase decision, however, is made by the insured patient, and once the patient has insurance, the marginal cost of health care is well below the price paid by the insurer. It is hardly possible to reduce the consumers’ purchases of medical care by lowering the prices they pay! Moreover, any group of insurance companies that sought to curtail the use of medical care enough to depress prices would cause consumers to go elsewhere for insurance, and physicians would withdraw from the plan. Firms offering coverage sufficient to purchase the quantity of services patients desired would have an advantage in selling policies. Thus if the monopsony explanation prevailed, the insurers subscribing to the maximum price plan would lose market share, as happens when monopoly is at work. If the share of firms (buyers or sellers) partic-

\textsuperscript{52} See Eisenberg, \textit{supra} note 31, at 453, for an argument that relative value scales for physicians are especially valuable to young practitioners who lack the information of their competitors. \textit{See also} Lynk, \textit{Regulatory Control of the Membership of Corporate Boards of Directors: The Blue Shield Case}, 24 J.L. \& Econ. 159 (1981) (finding that as the percentage of board members who are physicians rises, fee levels drop and suggesting that this represents competition by low-fee physicians for a larger market share).
ipating in the arrangement is increasing, this indicates efficiency-creating behavior rather than monopoly or monopsony.

C. Entry Deterrence

The final objection to maximum price fixing is that it impedes entry. Indeed, Professor Sullivan says that the “most likely” explanation for maximum prices is that “sellers (in an oligopolistic industry) fear entry if prices go higher and are conspiring to prevent this.” Sullivan characterizes entry-deterring pricing as a distortion of the economy’s ability to equate supply and demand. Others have expressed a similar concern; it is known in economics as limit pricing.

Those who advance this objection usually do not explain why lower prices deter entry. If the maximum price is less than marginal cost, the objection is the one usually advanced against predatory pricing. A maximum price less than marginal cost would prevent new entry for as long as the low price prevailed, but

53 L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 211 (1977). Sullivan also advances, albeit hesitantly, two other objections to maximum price fixing: that maximum prices will stifle changes in product characteristics and will allocate short supplies on nonprice grounds. He does not, however, offer any argument to support these concerns. There is no reason why maximum price agreements would impede innovation. And Sullivan does not show how conspirators could profit by allocating short supplies by quota rather than by price. I therefore disregard these potential objections. At all events, an analysis of “stabilization cartels”—agreements to keep price constant over time despite changes in demand—leads to the conclusion that such agreements sometimes benefit consumers. F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 216-20 (2d ed. 1980). Queuing may be preferable to price in allocating goods when there are unanticipated changes in demand. D. Carlton, The Disruptive Effect of Inflation on the Organization of Markets (Mar. 1981) (paper presented at National Bureau of Economics Conference on Inflation) (on file with The University of Chicago Law Review).

54 See Arizona v. Maricopa County Medical Soc’y, 643 F.2d 553, 565-68 (9th Cir. 1980) (Larson, J., dissenting), cert. granted, 101 S. Ct. 1512 (1981) (No. 80-419); Havighurst, Health Maintenance Organizations and the Market for Health Services, 35 LAW & CONTEMP. PROB. 716, 768-70 (1970); Kallstrom, supra note 29, at 678-84; Brief for the United States as Amicus Curiae in Support of Petition for Certiorari at 9-10, Maricopa (“competing doctors have a financial incentive to limit their fees by agreement only if that would limit new entry. . . . [T]he agreements . . . could be used as devices to impede entry by competing systems of prepaid health care, such as health maintenance organizations (‘HMOs’), or to forestall the development of other types of health care systems deemed undesirable by physicians operating under the currently prevailing methods”).

competition would resume as soon as the conspirators raised prices in an attempt to recoup. If the limit price exceeds marginal cost, however, the argument must be that certain firms, despite being able to set a monopoly price, have agreed to charge less than the monopoly price in order to reduce the risk of entry.

It is far from clear that limit pricing for this latter purpose is undesirable. The welfare loss from the entry-deterring price may be less than the welfare loss from the monopoly price. Even though the entry-deterring price will last longer, consumers do not lose as much in the early years as they do under monopoly pricing. The monopoly price attracts relatively inefficient firms, which limit pricing excludes. The productive inefficiencies of these firms are among the costs of monopoly. An argument that an industry prone to cartelization should be prevented from engaging in limit pricing thus is open to question.\(^6^8\)

Even if limit pricing is harmful, though, it is rare. Someone who maintains that a maximum price agreement is an example of entry-deterring pricing must establish that (1) the firms could have charged a monopoly price; (2) the limit price retards entry; and (3) buyers cannot maneuver around the limit price. None of these demonstrations is easy.

1. **Monopoly Price.** Sellers ordinarily can charge a monopoly price only if the market is concentrated. Sullivan explicitly qualifies his objection to maximum prices with a reference to oligopoly.\(^5^7\) If the sellers' market does not contain a dominant firm, a cartel, or oligopolists engaged in tacit collusion, there is no reason to worry that maximum price agreements amount to a forbearance to collect a monopoly price.\(^5^8\) Yet most of the examples of maximum price agreements involve markets that are unconcentrated on the sellers' side, such as medical services and retail sales.

2. **Limit Price and Entry.** Limit pricing usually does not limit entry. Firms can slow down entry by charging a price less than the monopoly price but more than the competitive price only if either the industry has significant economies of scale, or the potential entrants have costs higher than the incumbents (for example, if there is a barrier to entry). Economies of scale slow down

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\(^6^8\) Telex Corp. v. IBM, 510 F.2d 894 (10th Cir.), cert. dismissed, 423 U.S. 802 (1975), appears to hold that a monopolist may engage in limit pricing.

\(^5^7\) L. SULLIVAN, supra note 53, at 211.

\(^5^8\) On the conditions that generate monopoly profits or support tacit collusion, see Landes & Posner, supra note 47; see also R. POSNER & F. EASTERBROOK, supra note 25, at 331-46.
entry because a new firm must build a plant big enough to produce a significant fraction of the industry's output. This is a risky venture, and existing firms can make it more risky by holding capacity in reserve at the limit price. They effectively set a trap for entrants, ready to pounce if entry takes place. If there are barriers to entry, incumbent firms can protect their markets by charging slightly more than the costs the entrant would incur.

I doubt that limit pricing restricts entry even when there are economies of scale. Moreover, it is unlikely that incumbent firms engaged in limit pricing can make a profit larger than if they just set the monopoly price and let entry occur naturally. But one can reject Sullivan's concern even if one does not share my doubts. Sellers that employ maximum price agreements do not have significant scale economies. The agreements are used in markets where each seller has only a trivial share. Moreover, those who express concern about maximum price fixing do not seem to believe that the agreements impede entry by noble but less efficient rivals. The argument seems to be, rather, that the "excluded" potential entrants (such as health maintenance organizations or other prepaid health plans) are more efficient than those doing the "excluding" (such as physicians engaged in fee-for-service practice). This is impossible. No system of limit prices can exclude competition by \textit{more} efficient rivals. The only way for the incumbents (in an industry without scale economies) to limit entry is to reduce their prices to the costs of the potential entrants. And if the entrants' costs are lower than the incumbents', the incumbents will go broke.

3. \textit{Buyers and the Limit Price.} Buyers can foil most limit pricing schemes based on scale economies by signing long-term contracts with entrants. Because the limit price exceeds the rival's cost, and the only thing keeping the rivals out of the market is the risk that the incumbents will sell first and leave the entrant with insufficient demand to support the business and reap the economies of scale, customers can help rivals by guaranteeing them sufficient demand to reach efficient scales of production. If customers are willing to help entrants in this way, incumbents can deter entry only by charging the competitive price. Limit pricing by physicians quickly could be overcome by insurance companies sponsor-
ing rival forms of practice.\textsuperscript{61}

In sum, the argument that maximum price agreements deter entry is ridiculous when referring to more efficient potential entrants and implausible when referring to entrants that must operate at a certain minimum scale to be efficient. It safely can be disregarded as a source of antitrust concern.

IV. Horizontal Agreements and the Per Se Rule

The Supreme Court invented the per se rule against price fixing to deal with the argument, frequently advanced by cartelists in earlier years, that the agreed-on price was "reasonable" and therefore legal. The Court replied that the reasonableness of the price is irrelevant in a cartel case.\textsuperscript{62} It was wise to refuse to entertain such reasonableness arguments. A price is reasonable only in relation to marginal cost at the competitive output, and the objection to cartels is that they reduce output to less than the competitive quantity. No cartel price is reasonable in an economic sense. Even if the Court were prepared to undertake the heroic task of determining the variance between the competitive price and the cartel price, it would have no ground for saying that a particular deviation was acceptable. An argument that a cutback in output and a "reasonable" price increase are justified by some other purpose would be "nothing less than a frontal assault on the basic policy of the Sherman Act. . . . [T]he statutory policy precludes inquiry into the question whether competition is good or bad."\textsuperscript{63}

But while it rejected the cartel's attempts to argue the reasonableness of their prices, the Court accepted the proposition that not all cooperative behavior is unlawful. United States v. Addyston Pipe & Steel Co.\textsuperscript{64} recognized that restraints "ancillary" to lawful, productive conduct are themselves lawful. Sometimes these ancillary restraints entailed cooperation among competitors, but the cooperation was not subject to automatic condemnation. The

\textsuperscript{61} For example, insurers could establish their own health maintenance organizations. Long term contracts between the insurers and the HMOs would assure the survival of this form of practice, and if HMOs' costs are lower than the costs of traditional practice, the insurers would have no difficulty signing up customers. Thus entry would occur—indeed be encouraged—despite limit pricing.


\textsuperscript{63} National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 695 (1978).

\textsuperscript{64} 85 F. 271, 281-84 (6th Cir. 1898), modified and aff'd, 175 U.S. 211 (1899).
Court's announcement in the *Madison Oil* case that the law does not permit any inquiry into the economic justification for cooperation among rivals therefore reversed a longstanding approach to the per se doctrine. The Court did not cite *Addyston* or discuss the rationale (if there was one) for expanding per se treatment from a rejection of "reasonableness-of-price" arguments to a rejection of all conceivable arguments. It simply asserted the conclusion.

The approach of *Madison Oil* led to the per se condemnation of a wide variety of practices, including all sorts of cooperation among partially integrated firms. But it is impossible to justify a rule that refuses to examine the benefits of particular arrangements, no matter how substantial those benefits may be. The Supreme Court never has taken the per se rule as seriously as its statements might imply—consider the fate of attorneys who join in a partnership and agree on hourly fees for their services—and in recent cases, the Court has revived the earlier approach, so that substantial savings from cooperative endeavors avoid per se condemnation. The approval of the blanket license for musical compositions is the most vivid example. Sometimes *Addyston*’s ancillary restraint test will help a court identify those arrangements so likely to benefit consumers that more detailed scrutiny is desirable. Sometimes such identifiable benefits will exist independently of any "ancillary" arrangement among the competitors. Surely nothing should turn on the existence of an ancillary arrangement; the pertinent question is whether the prospect of consumer benefits is sufficient for a court to attempt the difficult and costly inquiry into their existence.

The costs of trying to separate beneficial agreements among competitors from anticompetitive agreements are large; one particular cost is the chance of error. Thus trivial savings are not enough to initiate an inquiry. The fact that cartels may save on selling costs by using a joint sales agent, for example, would not be enough to avoid the per se rule absent proof of some dramatic economies of scale in selling. (Such economies are unlikely.) The fact that a uniform cartel price reduces consumers' search costs

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also would be insufficient to avoid the rule; because cartel members have an incentive to shave the price and so capture additional sales, consumers would have an incentive to search for price-cutters, and search costs might even rise as a result. At some point, though, the savings from cooperation become so large in relation to the costs of inquiry (including the costs of error) under the Rule of Reason that there is no longer adequate justification for using per se rules. I have argued in this article that the balance shifts when rivals agree to set maximum prices. It should be possible to examine the maximum price agreement and determine with some reliability whether consumers save or whether, instead, the agreement is a disguised cartel. This inquiry may cause discomfort to those who are used to the idea that all price fixing is unlawful. We cannot, however, long afford to follow a per se rule that condemns efficient practices simply because they have names similar to those of other practices that are more likely to be anticompetitive.

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68 For this reason, Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980), is consistent with the position I have adopted. See also note 45 supra, discussing Professor Dewey's views.