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Vertical Maximum Price Fixing: *State Oil v. Khan*

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Summary

Respondent Khan and his corporation entered into an agreement with petitioner State Oil to lease and operate a gas station owned by State Oil. Respondents agreed to obtain the station's gasoline supply from State Oil at a price equal to a suggested retail price set by State Oil. The Supreme Court granted certiorari to consider whether State Oil's conduct constituted a per se violation of the Sherman Act.

The Court held that State Oil's conduct did not constitute a per se violation of the Sherman Act, thereby overruling an earlier Supreme Court case, *Albrecht v. Herald Co.* The Court stated that, in overruling *Albrecht*, it was not holding that all vertical maximum price fixing is per se lawful. Instead, vertical maximum price fixing should be evaluated under the rule of reason.

Discussion

Respondent Khan and his corporation entered into an agreement with petitioner State Oil to lease and operate a gas station owned by State Oil. Respondents agreed to obtain the station's gasoline supply from State Oil at a price equal to a suggested retail price set by State Oil, less a margin of 3.25 cents per gallon. Respondents could charge any amount for the gasoline sold to its customers, but, if it charged a price higher than State Oil's suggested retail price, the amount over 3.25 cents per gallon had to be rebated to State Oil. If respondents sold gasoline for less than the suggested retail price, the decrease would reduce its profit margin.

Respondents later fell behind in lease payments, and State Oil gave notice of its intent to terminate the agreement. The state court appointed a receiver to operate the gas station, and the receiver was not subject to the price restraints. The receiver had an overall profit margin more than 3.25 cents per gallon by lowering the price of regular-grade gasoline and raising the price of premium gasoline.

Respondents sued State Oil in the United States District Court for the Northern District of Illinois and alleged that State Oil had engaged in price fixing in violation of

Section 1 of the Sherman Act¹ by preventing the raising or lowering of retail gas prices. Respondents claimed that, by charging different prices on grades of gasoline as the receiver did, it could have increased sales and profits.

The District Court found that the allegations did not state a per se violation of the Sherman Act because they did not have the manifestly anticompetitive implications or pernicious effect on competition that is required to justify finding a per se violation. The District Court also concluded that respondents did not demonstrate antitrust injury or harm to competition. The District Court entered summary judgment for State Oil.

The Court of Appeals for the Seventh Circuit reversed.² The Seventh Circuit, after reviewing the legal and economic aspects of price fixing, concluded that State Oil's pricing scheme was a per se antitrust violation under an earlier Supreme Court decision, *Albrecht v. Herald Co.*,³ in which the Supreme Court held that the action of a newspaper publisher in fixing a ceiling at which its distributors could resell the newspaper to the public was illegal per se. Yet, the Seventh Circuit expressed dissatisfaction with the *Albrecht* ruling.

We have considerable sympathy with the argument that *Albrecht* is inconsistent with the cases that establish the requirement of proving antitrust injury. In fact, we think the argument is right and that it may well portend the doom of *Albrecht*. In *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 706-07 (7th Cir. 1984), we said we regarded the continued validity of *Albrecht* as an open question, albeit for a different reason; that after *Albrecht* the Supreme Court had (reversing its previous position) recognized that exclusive dealer territories may be procompetitive. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977). As we pointed out earlier in this opinion, and as one of the dissenting opinions in *Albrecht* had pointed out as well, 390 U.S. at 169, 88 S.Ct. at 881-82, a price ceiling is a natural and procompetitive incident to a scheme of territorial exclusivity. The majority opinion in *Albrecht* had rejected this argument on the ground that price fixing cannot be "justified because it blunts the pernicious consequences of another distribution practice," 390 U.S. at 154, 88 S.Ct. at 874, namely exclusive territories. We now know that the consequences of that other practice are not (not generally, at any rate) pernicious. So another prop beneath *Albrecht* has been knocked away, although State Oil does not make the argument from *Sylvania*, maybe because it does not grant its dealers exclusive territories (the record is silent on the matter).⁴

The Supreme Court granted certiorari to consider whether State Oil's conduct constituted a per se violation of the Sherman Act and whether respondents are entitled to damages based on State Oil's conduct.

¹ 15 U.S.C. § 1.

² 93 F.3d 1358 (1996).

³ 390 U.S. 145 (1968).

⁴ 93 F.3d at 1363.

The Court held that State Oil's conduct did not constitute a per se violation of the Sherman Act, thereby overruling *Albrecht*, and remanded to the Court of Appeals the question of whether respondents are entitled to recover damages in light of the overruling of *Albrecht*.⁵

Not only are the potential injuries cited in *Albrecht* less serious than the Court imagined, the *per se* rule established therein could in fact exacerbate problems related to the unrestrained exercise of market power by monopolist-dealers. Indeed, both courts and antitrust scholars have noted that *Albrecht*'s rule may actually harm consumers and manufacturers. See, e.g., *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 19 F.3d 745, 753 (C.A. 1 1994) (Breyer, C.J.); Areeda, *supra*, par. 1636a, at 395; G. Mathewson & R. Winter, *Competition Policy and Vertical Exchange* 13-14 (1985). Other commentators have also explained that *Albrecht*'s *per se* rule has even more potential for deleterious effect on competition after our decision in *GTE Sylvania*, because, now that vertical nonprice restrictions are not unlawful *per se*, the likelihood of dealer monopoly power is increased....

After reconsidering *Albrecht*'s rationale and the substantial criticism the decision has received, however, we conclude that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing. That is so not only because it is difficult to accept the assumptions underlying *Albrecht*, but also because *Albrecht* has little or no relevance to ongoing enforcement of the Sherman Act.⁶

The Court went on to state that, in overruling *Albrecht*, it was not holding that all vertical maximum price fixing is per se lawful. Instead, the Court stated, like most commercial arrangements subject to the antitrust laws, vertical maximum price fixing should be evaluated under the rule of reason.

As for whether respondents are entitled to damages based on State Oil's conduct, the Court held that, with its overruling of *Albrecht*, this issue should be reviewed by the Court of Appeals in the first instance.

⁵ *State Oil Co. v. Khan*, 118 S.Ct. 275 (1997).

⁶ 118 S.Ct. at 283.