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Advisory

Minimum Resale Price Maintenance Now Under High Court Review

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For nearly a century, agreements between buyers and sellers on the minimum price at which the buyer will resell have been illegal *per se* under Section 1 of the Sherman Act.[1] This absolute rule against minimum resale price maintenance ("Minimum RPM") may be about to change. On March 26 the Supreme Court heard oral argument in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, Docket No. 06-480, and a decision is expected by the end of the current Supreme Court term in June.

Plaintiff PSKS, a women's wear and accessories retailer, won a jury verdict in Texas federal court against Leegin, maker of a profitable line of women's handbags. Plaintiff charged that Leegin imposed Minimum RPM agreements on retailers – and stopped shipping when PSKS discounted below Leegin's required minimum prices. Leegin, admitting the Minimum RPM agreements *arguendo*, asked the court to find that such agreements are *not* automatically unlawful. The district court declined the invitation on the strength of *Dr. Miles*: "A dealer terminated for discounting under the circumstances presented here suffers antitrust injury as a matter of law."[2]

The Fifth Circuit affirmed, rejecting Leegin's contention that Minimum RPM should be analyzed under the rule of reason rather than condemned *per se*.[3] The court observed, in pertinent part that:

- The Supreme Court has consistently declared Minimum RPM to be illegal *per se* – even if no actual competitive harm is proved.
- Hence, at trial, Leegin's proffered expert testimony on economic conditions in the industry and the allegedly procompetitive effects of its Minimum RPM pricing policy would have been irrelevant.
- Moreover, evidence at trial showed that "PSKS suffered antitrust injury. Its refusal to follow Leegin's pricing policy resulted in inability to obtain its best-selling and most profitable product line."

Leegin petitioned for *certiorari*, asserting that "accumulated economic knowledge … recognizes that [Minimum RPM] can have significant **procompetitive** effects" and that "modern antitrust jurisprudence" has "revisit[ed] and reject[ed] analogous *per se* rules" that formerly prohibited other types of vertical agreements, such as **maximum** resale price maintenance.[4] Leegin portrayed itself as a champion of interbrand competition: a "small competitor," using Minimum RPM "to provide incentives for retailers to market its products effectively against its larger rivals." [5] Many uses of Minimum RPM, Leegin pointed out, have been identified as enhancing competition and consumer welfare. Leegin's own uses – "to bring new products and services to consumers and to use small retailers to compete against prominent national brands" – were, not surprisingly, claimed to be among them.

Even if unwilling to overturn the *per se* rule in its entirety, Leegin said, the Court at least should limit its application to cases in which the supplier imposing Minimum RPM has market power.

PSKS opposed the petition, citing long-standing judicial – and Congressional – acceptance of a *per se* rule against Minimum RPM. PSKS contended that "the *Dr. Miles* rule is clear and easily enforceable," as well as "consistent with modern economic analysis."[6] PSKS also portrayed Leegin as a dual-distributing manufacturer – *i.e.*, not just a supplier but also, via its own retail stores, a competitor of PSKS.[7] As such, PSKS argued, Leegin's purportedly "vertical" price-setting was actually a "retailer cartel" in which Leegin directed "a collusive, horizontal scheme to fix prices at the retail level," an obvious *per se* violation.[8]

Following the Court's grant of *certiorari* on December 7, 2006, several *amici curiae* filed briefs, most supporting Leegin. Leegin's supporters included the U.S. Solicitor General and the two federal antitrust agencies, the U.S. Federal Trade Commission ("FTC") and the Antitrust Division, U.S. Department of Justice ("the Agencies").[9] Conceding that, on one hand, Minimum RPM "can harm consumer welfare by supporting cartel efforts by manufacturers or dealers," the Agencies emphasized, on the other hand, that Minimum RPM can also "stimulate interbrand competition by giving retailers incentives to promote the manufacturer's brand." Hence, according to the Agencies, Minimum RPM should be treated like **nonprice** vertical restraints which, although they too can be misused for anticompetitive purposes, have been subject to the rule of reason since the Supreme Court's 1977 decision in *Continental T.V., Inc. v. GTE Sylvania Inc.* ("*Sylvania*").[10] *Per se* punishment should be reserved for restraints "that have a 'pernicious effect on competition and lack ... any redeeming virtue,'" the Agencies said.[11]

The Agencies repeated two familiar arguments in favor of Minimum RPM:

- By guaranteeing the retailer a certain margin over its cost, Minimum RPM provides retailers with an incentive to spend on promotion, service and inventory "in order to attract additional customers."[12] Minimum RPM focuses the retailer on competing effectively against other brands, rather than against other sellers of the same brand, and thus "accomplishes directly what nonprice vertical restraints accomplish indirectly."[13]

- Minimum RPM counteracts the "free-riding problem" that arises when, after a full-service retailer has invested in promotion and made a product desirable, its no-frills competitor (which made little or no similar investment) siphons off customers by simply offering lower prices. Free-riding opportunities, the Agencies emphasized, have been "exacerbated by catalog retailing and the advent of the Internet."[14]

The Agencies briefly identified and rebutted several of the reasons that have been advanced for continuing *per se* treatment of Minimum RPM.[15] Several of these, set forth in *Dr. Miles* and later Supreme Court cases, are no longer valid in light of the Court's *Sylvania* decision, the Agencies argued. Others, expressed in the

Sylvania decision itself, have since proved not to be problematic in light of later jurisprudence and economic research.

Not all governments agreed. Thirty-seven States sided with PSKS, as did Pamela Jones Harbour, one of two FTC Commissioners who voted not to join in the Agencies' brief. Commissioner Harbour published an "Open Letter" to the Court setting out her view that Minimum RPM should remain illegal as a matter of law.[16] The Open Letter observed that the direct effects of Minimum RPM – higher retail prices and extra profits for retailers – do not necessarily generate actual consumer benefits. Indeed, the Open Letter argued, the "guaranteed margins" produced by Minimum RPM are "little more than a consumer-funded bribe to retailers."[17] If Leegin's (and the Agencies') position were accepted, the Open Letter claimed, prices will rise, retail sales volumes will fall, and other aspects of vigorous competition will suffer.[18] Ill effects of that kind, according to the Open Letter, induced Congress in 1975 to repeal the Miller-Tydings Act (1937) and the McGuire Act (1952), which for decades had provided federal antitrust exemptions to Minimum RPM agreements authorized by state "fair trade" laws.[19] Unfettered Minimum RPM, according to the Open Letter, would make retailers "function solely as the sales agents for manufacturers" and substantially stop retailers from acting as "purchasing agents for consumers."[20] Apart from such basically vertical objections to Minimum RPM, the Open Letter argued, in this case "Leegin appears to have crafted a [*per-se* illegal] **horizontal** price fixing agreement to protect its own stores from competition with other retailers."[21] Leegin, the Open Letter contended, failed to identify how its Minimum RPM policies had actually helped consumers. Ladies handbags, the Open Letter pointed out, are not technologically sophisticated products requiring retailer investment in pre-sale customer demonstration and education or post-sale service and repair – the types of expenditures which, since they help consumers, have been found to justify higher resale prices.[22]

The Open Letter concluded by proposing to replace the *per se* rule with a presumption that Minimum RPM is unlawful, but also allowing the defendant to rebut the presumption with "a *factual*, case-specific showing" that the Minimum RPM at issue is necessary to deliver consumer benefits at least as great as the increased resale prices, and that those benefits could not be achieved by less restrictive means.[23] That mode of rebuttal would resemble the Agencies' existing method for identifying procompetitive benefits in collaborations among competitors.[24]

At oral argument on March 26:

- Justices Ginsburg, Stevens, Kennedy and Breyer voiced concern that, if the *per se* ban were overturned, Minimum RPM agreements could facilitate horizontal price-fixing among retailers and result in higher prices to consumers. PSKS's counsel reinforced the point by arguing "we have clear evidence that RPM was used to facilitate a horizontal retailer cartel" in this case.

- Leegin's counsel posited that suppliers value Minimum RPM as a way to stimulate interbrand competition by giving dealers the financial incentive to provide service and product variety. In some instances, of course, that is not the case. Some suppliers would prefer not to impose or suggest minimum resale prices, but powerful dealers – acting in parallel, though rarely by express agreement – insist on a resale price floor as a condition for handling the supplier's products. Small suppliers and new entrants are particularly vulnerable to such dealer pressure.

- Justice Souter suggested that suppliers' increased use of Minimum RPM might discourage price-cutting discounters and mass merchants, producing a potentially "massive reorientation in the retail economy" for which Congress, rather than the Court, might more appropriately take responsibility.

- In a similar vein, Justice Breyer asked: "Why should we overrule a case that's 96 years old, in the absence of any Congressional indication that that's a good idea?" Justice Breyer was particularly concerned that the arguments made to overrule *Dr. Miles* appeared to him to be the same arguments made in the 1960s.

- Justice Scalia, in contrast, argued that "the mere fact that [Minimum RPM] would increase prices doesn't prove anything," because it encourages retailers to provide more services for which customers are willing to pay, and discourages free riders who would otherwise make those added services unprofitable to the retailer. Suppliers will not set the minimum resale prices too high, Justice Scalia contended, because their motive is to stimulate sales volume and keep the retailer's margin as low as possible.

- Another issue the Justices explored was whether the *per se* rule could be left standing because a supplier's **unilateral** right to dictate resale prices to its retailers – the so-called *Colgate* doctrine[25] – offers suppliers a viable way to achieve the same goals as a Minimum RPM agreement.

Chief Justice Roberts and Justices Kennedy and Alito asked few questions, but the Chief Justice did question whether the retail industry – particularly discount stores – had developed in reliance on *Dr. Miles.* He also asked, when told that the *Colgate* doctrine allows suppliers to impose Minimum RPM, "what's the great benefit then in changing the rule if it's perfectly legal to achieve the same result already?"

Many antitrust practitioners had assumed that the Court was ready to overrule *Dr. Miles*, but the oral argument suggests that there are at least four votes (Justices Stevens, Souter, Breyer and Ginsburg) inclined to uphold it. While Justice Scalia clearly would overrule *Dr. Miles*, it is not at all clear that all of his remaining colleagues agree. The weight of precedent, conflicting economic views, and – especially – Congressional action supporting *Dr. Miles* (by repealing, in 1975, the 1937 Miller-Tydings Act and the 1952 McGuire Act) might lead to a surprise outcome.

If *Dr. Miles* is overruled, manufacturers and retailers will need to reexamine their distribution policies. The questions at argument made clear that, at least for today, most members of the Court would view agreements among retailers to insist on Minimum RPM from a manufacturer to be *per se* violations of the Sherman Act. Other issues may arise in dual-distribution situations. Companies seeking to implement Minimum RPM might need to safeguard against the risk of claims that horizontal conspiracies are present.

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[1] Dr. Miles Medical Co. v. John D. Park & Co., 220 U.S. 373 (1911) ("Dr. Miles").

[2] See PSKS, Inc. v. Leegin Creative Leather Products, Inc., Case No. 2:03-CV-107 (TJW) (E.D.Tex.), Order dated August 17, 2004.

[3] 171 Fed. Appx. 464 (5th Cir. 2006).

[4] No. 06-480, Petition for Writ of Certiorari dated October 4, 2006, at 2.

[5] Id. at 6.

[6] Id. at 21.

[7] Brief in Opposition dated November 6, 2006, at 1.

[8] Id. at 4-5.

[9] Brief for the United States as Amicus Curiae Supporting Petitioner dated January 22, 2007 ("U.S. Amicus"). The FTC's five commissioners split 3-2 over whether to join in this brief.

[10] 433 U.S. 36 (1977).

[11] U.S. Amicus at 8, quoting Northern Pac. Ry. v. United States, 456 U.S. 1, 5 (1958).

[12] U.S. Amicus at 11.

[13] Id. at 12.

[14] Id. at 13.

[15] Id. at 16-24.

[16] An Open Letter to the Supreme Court of the United States from Commissioner Pamela Jones Harbour dated February 26, 2007, at 3 ("Open Letter").

[17] Id. at 7.

[18] Id. at 9-10.

[19] Id. at 11-13.

[20] Id. at 14.

[21] Id. at 15 (emphasis added).

[22] Id. at 17.

[23] Id. at 18 (emphasis in original). The Open Letter contended, however, that the Leegin case would not be appropriate for this proposed treatment, because "the facts of this … case do not justify overturning Dr. Miles."

[24] See Antitrust Guidelines for Collaborations Among Competitors (2000) at § 3.36

[25] United States v. Colgate & Co., 250 U.S. 300, 307 (1919).