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Supreme Court Abandons *Per Se* Prohibition of Resale Price Maintenance

by Richard Liebeskind, Bruce W. McDiarmid and Joseph R. Tiffany

On the last day of the 2006 Term, by a five-to-four vote, the U.S. Supreme Court held that minimum resale price maintenance – commonly called RPM – would no longer constitute a *per se* violation of the antitrust laws, overruling its 1911 decision in *Dr. Miles*.¹ In doing so, the Court followed the recommendation of the Solicitor General, the Antitrust Division of the U.S. Department of Justice, and the Federal Trade Commission, and many but not all economists.

In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, No. 06-480, the Court (in an opinion by Justice Kennedy, writing for himself, Chief Justice Roberts, and Justices Scalia, Thomas and Alito) held that resale price maintenance would now be governed by the “rule of reason,” under which RPM’s legality would be evaluated based on the defendants’ market power, competitive justifications offered and the likely anticompetitive effect of the practice. “‘Under this rule, the fact-finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.’”² Under a *per se* rule, by contrast, proof of the agreement generally suffices to prove the violation (although a private plaintiff must still prove antitrust injury and damages).

While *Dr. Miles* and later cases held that RPM was illegal *per se*, the Supreme Court had also long recognized that a manufacturer generally has the right to deal or not deal with distributors and retailers as it saw fit—known as the *Colgate* doctrine.³ To reconcile the two doctrines, the Court has held that a manufacturer may suggest resale prices to its retailer—and may terminate retailers who do not follow the suggestion—so long as the manufacturer and retailer do not actually agree on the price to be charged.

The *Leegin* decision may simplify retailers’ lives by obviating the need for “*Colgate* policies” and the risk that they stray into actual agreement. Indeed, the Court recognized that its prior RPM jurisprudence “is a flawed antitrust doctrine that serves the interests of lawyers—by creating legal distinctions that operate as traps for the unwary.” *Slip op.* at 25. *Leegin* should also protect most “minimum advertised price” (“MAP”) policies,

under which the manufacturer requires the retailer to *advertise* prices no lower than a specified minimum, unless the policies are the product of a horizontal cartel.

Instead, many manufacturers will be able to implement resale price maintenance and establish the retail prices of their products—if they can persuade retailers to carry their products on that basis. So long as the manufacturer has a relatively small share in its market, it should be able to agree with its retailers on the prices to be charged for its products without fear of *federal* antitrust liability. New products and new manufacturers, in particular, can rely on *Leegin*'s acknowledgement that RPM may promote their entry into the market.

Two caveats: *States* might interpret their own antitrust laws differently (or might reimpose RPM prohibitions legislatively),⁴ and some plaintiffs might allege surprisingly narrow market definitions.⁵ For manufacturers with larger market shares, *Leegin* may have the ironic effect of leading to more protracted antitrust litigation over RPM, in which the parties must join issue on the many elements of a rule-of-reason case.

Leegin in Context – Another Step in the March Toward Rule-of-Reason Treatment for Vertical Restraints

In overruling *Dr. Miles* and making RPM subject to the rule of reason, the Court has followed a 30-year trend to make “vertical restraints”—agreements between manufacturers and retailers, or between other firms that are not direct competitors—subject to the rule of reason rather than subject to *per se* condemnation. This trend began with *GTE Sylvania*, which held that territorial allocations by manufacturers were to be evaluated under the rule of reason rather than condemned as *per se* illegal. In *Jefferson Parish*, a divided Court weakened the *per se* rule against tying—the majority holding that tying claims must focus on the anticompetitive effects in the tied product market, and the dissenters arguing that tying should be judged under the rule of reason. In *State Oil v. Khan*, the Court held that *maximum* resale price maintenance should be evaluated under the rule of reason rather than a *per se* rule.⁶ Exclusive dealing and other vertical arrangements are now generally judged under the rule of reason as well. Indeed, as the Court writes, “the Court has abandoned the rule of *per se* illegality for other vertical restraints a manufacturer imposes on its distributors.” *Slip op. at 1*.

The practical effect of rule-of-reason treatment has been that most vertical arrangements have passed muster under Section 1 of the Sherman Act, 15 U.S.C. § 1, which prohibits agreements in restraint of trade. A somewhat surprising development has been that some of these practices have been held in specific cases to violate Section 2 of the Sherman Act, 15 U.S.C. § 2, which prohibits monopolization and attempted monopolization. Thus, for example, 3M Corporation was found to have monopolized the market for transparent tape through a tying arrangement, even though the arrangement itself was found *not* to constitute an unlawful agreement, and Dentsply Inc. was found to have monopolized the market for false teeth through an exclusive dealing arrangement that likewise was found not to be unlawful of itself.⁷

Leegin continues another trend: For fifteen years, the Supreme Court has invariably ruled for defendants in antitrust cases. This term's decision in *Leegin* follows its decisions in three other antitrust cases this term⁸—in all of which defendants prevailed. Indeed, no plaintiff has won a significant antitrust case in the Supreme Court since 1992.⁹

The essential argument in favor of making minimum RPM lawful in most cases is that, by protecting a retailer from “intra-brand” competition from discounters, the retailer is more likely to invest in services—attractive stores, knowledgeable salespeople—that would promote the sale of the manufacturer's product in competition with other manufacturers' products. “This is because discounting retailers can free ride on retailers who

furnish services and then capture some of the increased demand those services generate. ... Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services." *Slip op. at 10-11*. Notably, the implication of the "free riding" justification is that the manufacturer is employing RPM with all of its retailers, so that the retailer who invests in service knows that he will not be undercut by free riders.¹⁰

At the same time, the Court recognizes that "resale price maintenance may, however, facilitate a manufacturer cartel," perhaps by assisting the cartel in detecting deviations by manufacturer members. *Id. at 12*. Likewise, RPM might facilitate a retail cartel. "A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful." *Id. at 13*. The Court therefore says it would find RPM "entered upon to facilitate either type of cartel" to violate the rule of reason. *Id.*

Moreover, "this type of evidence [of RPM] may also be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel." *Id.* A plaintiff alleging that RPM constitutes evidence of an otherwise secret horizontal cartel might rely on *Leegin* to claim that his complaint should survive a motion to dismiss for failure to allege sufficient facts to support an allegation of an agreement – and the defendant will rely on the Court's decision this term in *Twombly* to argue that an allegation of lawful conduct cannot support a conclusory allegation of conspiracy.¹¹

The Court also suggests that rule-of-reason RPM claims might be successful where RPM is "abused by a powerful manufacturer or retailer." *Id.* A retailer that demands RPM "to forestall innovation in distribution that decreases costs," or a manufacturer that "use[s] resale price maintenance to give retailers an incentive not to sell products of smaller rivals or new entrants" could be challenged as having engaged in RPM with "evident" anticompetitive effects. *Id. at 14*. Leading firms contemplating minimum RPM should seek counsel regarding the risks of rule-of-reason challenges, and should develop the pro-competitive reasons for adopting the practice.

Justice Breyer, joined in dissent by Justices Stevens, Souter and Ginsburg, would sustain *Dr. Miles* based on principles of *stare decisis*. "Were the Court writing on a blank slate, I would find these questions difficult." *Dissent at 3*. He notes that the arguments supporting RPM were not new, and had been rejected by the Court and Congress in the past. Therefore, given his perception of the ambiguity of the pro-competitive and anticompetitive effects of RPM, the dissenters would have affirmed the existing precedent.

The dissent predicts that the *Leegin* decision will unsettle the law, and companies in the business of selling consumer goods—both manufacturers and retailers—can now rethink their distribution strategies. As the majority notes, however, "the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated." *Slip op. at 14*.

Recap: Practical Implications of *Leegin* for Manufacturers and Retailers

While the full practical implications of *Leegin* will emerge gradually in the courts and possible state and federal legislative responses, some preliminary observations can be made:

- Manufacturers and retailers with relatively small market shares should be able to implement RPM policies and establish the resale prices of their products without fear of *federal* liability. Whether to do so requires a careful assessment of business objectives, the competitive environment and the impact on existing

reseller arrangements. For example, if a manufacturer imposes RPM, the manufacturer is then faced with the task of policing it.

- Some important caveats: *States* may interpret their own statutes differently (and existing state case law in many states may treat RPM as a *per se* violation) or reimpose RPM prohibitions legislatively. Antitrust *plaintiffs* may also allege narrow market definitions to advance rule-of-reason claims. A future federal legislative response to *Leegin* is also possible.
- *Leegin* deals with a two-party distribution system, i.e., manufacturer to retailer. Its application to the equally common three-party distribution system, i.e., manufacturer to distributor to retailer, remains to be fully worked out. Typically, a manufacturer will have no interest in controlling a distributor's resale prices unless the manufacturer can also control the retailer's resale prices. This means that the manufacturer's agreement with the distributor will have to require the distributor to impose RPM on the distributor's customers and specify the resale price for the distributor. While *Leegin* implicitly allows this, a manufacturer with a multi-tier distribution system must proceed with greater care.¹²
- *Leegin* should obviate the need for "Colgate policies" designed to establish resale prices without being found to have entered into an actual agreement with resellers, *unless* the policies are the product of a horizontal cartel. Whether to retain a successful Colgate policy should be evaluated in light of business objectives on a case-by-case basis.
- *Leegin* should protect most "minimum advertised price" policies.
- *Leegin* holds that RPM arrangements used to facilitate manufacturer or retailer cartels are unlawful under the rule of reason. Companies considering implementing RPM policies should work with counsel to minimize risks that doing so could be construed as facilitating a cartel or as evidence of cartel activity.
- Firms with significant market shares should be careful in implementing RPM policies and seek legal advice regarding antitrust market analysis in order to minimize risks. Consideration should be given to possible rule-of-reason challenges and establishing pro-competitive reasons for adopting RPM.
- Imposition of RPM policies on a selective basis among resellers raises potential issues of discrimination and unfair competition and should be considered carefully with legal counsel.
- *Leegin* is likely to have significant commercial ramifications for manufacturers. Traditional retailers may prefer to deal with manufacturers that engage in RPM and may avoid (or give second tier treatment to) those who do not. Conversely, large discounters (who have become very important in the marketplace) will disfavor (or may not do business with) manufacturers that engage in RPM. An entirely new dynamic may be added to these relationships and the resulting tensions may very well have legal implications.
- RPM also raises potentially difficult legal issues under long-term contracts that have "open price" terms, where the retailer's buying price and resale price can be changed by the manufacturer from time to time during the term of the contract. Disputes may ensue if the "locked-in" retailer believes the imputed "margin" is too low. In such circumstances the manufacturer may face suit under section 2-305 of the Uniform Commercial Code, which requires that such prices be set by the manufacturer in "good faith."

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Live Link

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For further information, please contact:

Richard Liebeskind (bio)

Washington, DC
+1.202.663.9238
richard.liebeskind@pillsburylaw.com

Joseph R. Tiffany (bio)

Silicon Valley
+1.650.233.4644
joseph.tiffany@pillsburylaw.com

Bruce W. McDiarmid (bio)

San Francisco
+1.415.983.1043
bruce.mcdiarmid@pillsburylaw.com

Daveed A. Schwartz (bio)

Sacramento
+1.916.329.4748
daveed.schwartz@pillsburylaw.com

¹ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

² *Leegin*, slip op. at 5, quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977).

³ *U.S. v. Colgate & Co.*, 250 U.S. 300 (1919).

⁴ In fact, case law in many states (usually based on *Dr. Miles*) treats RPM as *per se* unlawful under state law. While it can be expected that most of these courts will eventually follow federal law, RPM should be approached with caution in such states unless and until the state court adopts *Leegin*.

⁵ For example, the FTC is currently alleging that “premium natural and organic supermarkets” constitute a distinct product market. *FTC v. Whole Foods Market, Inc.*, case no. 1:07-cv-01021 (D.D.C. filed June 6, 2007).

⁶ *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

⁷ *LePage's Inc. v. 3M Co.*, 324 F.3d 141 (3d Cir. 2003); *US v. Dentsply Int'l*, 399 F.3d 181 (3d Cir. 2005).

⁸ *Credit Suisse Securities (USA) LLC v. Billing*, 127 S. Ct. 2383 (2007); *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007).

⁹ *Eastman Kodak Co. v. Image Tech. Services*, 504 U.S. 451 (1992). *Kodak* is now seen as an outlier, and was not even cited in the Court's more recent *Trinko* decision, even though both cases dealt with the duties of an alleged monopolist to deal with its smaller competitors. *Verizon Communications Corp. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

¹⁰ Nonetheless it would be anomalous for a court to require that a manufacturer impose RPM uniformly rather than selectively among the retailers whom the manufacturer wishes to encourage to provide more service.

¹¹ *Twombly*, 127 S. Ct. at 1971-72 (actions equally explainable as unilateral cannot serve as basis to infer cartel); see “Client Alert: U.S. Supreme Court Raises the Pleading Standard for Antitrust Conspiracies and—Maybe—All Civil Complaints”

¹² For example, there is case law under the Robinson-Patman Act allowing indirect purchasers to sue the manufacturer for price discrimination if it can be shown that the manufacturer controlled the reseller's prices (see, e.g., *American News Company v. Federal Trade Commission*, 300 F.2d 104 (2d Cir. 1962), cert. denied, 371 U.S. 824 (1962)).

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