PROSKAUER ROSE LLP®

# Client Alert

A report for clients and friends of the Firm

June 2007

## Manufacturers, Set Your Prices: Supreme Court Rules Minimum Resale Price Maintenance Agreements No Longer *Per Se* Illegal

On June 28, 2007, the Supreme Court issued its decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. ___, Case No. 06-480, 2007 WL 1835892, the last of four antitrust cases decided by the Court this term.[1]

In *Leegin*, the Court overruled long-standing precedent and held that vertical minimum resale price maintenance ("RPM") agreements are no longer *per se* illegal under federal law; state law remains unsettled. RPM agreements thus join maximum resale price agreements and non-price agreements as vertical arrangements now recognized by the Court to have the potential for significant procompetitive effects. The Court will therefore apply a rule of reason analysis to RPM agreements. This decision directly impacts the distribution and marketing practices of manufacturers and retailers. Federal law now permits manufacturers, in appropriate circumstances, to enter into (and enforce) agreements with distributors and retailers requiring that the manufacturers' products be sold at or above a certain price.

### The Facts and Background of *Leegin*

Leegin is the manufacturer of the Brighton line of women's accessories. Plaintiff PSKS operated the retail store "Kay's Kloset" and was among the retailers to whom Leegin sold the Brighton products. In 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy" pursuant to which the company would do business with only those retailers who followed its suggested minimum retail prices for its products. A year later it also initiated a marketing strategy called the "Heart Store Program." Under this program, Leegin offered incentives to retailers in exchange for their agreement to sell at Leegin's suggested prices. PSKS was a member of the program only during 1998, but remained a retailer thereafter. In December 2002, Leegin learned that PSKS was selling Brighton products below the suggested prices in violation of the pricing policy and suspended all shipments of its Brighton products to PSKS. PSKS then filed suit alleging that Leegin's Heart Store program, *inter alia,* evidenced Leegin's unlawful agreements with retailers to fix Brighton products' prices, conduct that restrains trade under Section 1 of the Sherman Act.

At trial, the U.S. District Court for the Eastern District of Texas applied the *per se* rule against minimum resale price maintenance agreements established 96 years ago by the Supreme Court in *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911). Under this rule, the only question for the jury was whether or not Leegin and its retailers agreed to fix the retail prices of the Brighton products. Accordingly, the Court refused to admit expert economic evidence that the pricing policy was actually procompetitive because it promoted interbrand competition. The Fifth Circuit affirmed the district court's decision, explaining that it was bound by *Dr. Miles* "[b]ecause [the Supreme] Court has consistently applied the *per se* rule to [vertical minimum price-fixing] agreements." 171 Fed. Appx. 464, 466 (5th Cir. 2006). On December 7, 2006, the Supreme Court granted *certiorari*. The Court heard oral argument in the case on March 26, 2007.

### The Appeal

The question presented was very straightforward: whether or not to overrule *Dr. Miles*, by holding that vertical

[1] The other three were *Weyerhaeuser Co. v. Ross Simmons Hardwood Lumber Co.,* 549 U.S. __, Case No. 05-381, Feb. 20, 2007, *Bell Atlantic Corp. v. Twombly*, 550 U.S. __, Case No. 05-1126, May 21, 2007, and *Credit Suisse Securities (USA) LLC. v. Billing*, 551 U.S. __, Case No. 05-1157, June 18, 2007.

minimum price maintenance agreements should be subject to the rule of reason rather than illegal *per se.*

Leegin's challenge to Dr. Miles was supported by six *amici curiae*, including, *inter alia*, the U.S. Department of Justice and an assortment of economists and economic scholars. The principal argument in Leegin's favor was that *Dr. Miles* was based on out-moded analysis and antiquated principles that have no grounding in modern economics. Current analysis demonstrates that resale price maintenance can have procompetitive effects and may enhance consumer welfare, and therefore should not be automatically condemned. For example, manufacturers could impose a price floor on their retailers in order to ensure that the dealers provide demand-creating services, such as improved customer service and promotion of the products. Also, new-entrant manufacturers could use the restrictions to induce retailers to invest the capital and labor needed to market and distribute their not-yet-known products. In addition, RPM agreements are a powerful tool by which manufacturers can counter the "free-rider problem" — in which customers visit stores that offer better service and selection in order to make their choices, then purchase the products at lower prices from discount or online retailers who do not offer such services. Leegin also pointed to its pricing policy as one that promoted interbrand competition, which is the "primary concern of antitrust law" (quoting *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977)), even if it reduced intrabrand competition. Moreover, more recent Supreme Court decisions reject per se treatment of vertical arrangements such as vertical non-price agreements (GTE Sylvania, 433 U.S. 36) and vertical maximum price maintenance agreements (*State Oil Co. v. Khan*, 522 U.S. 3 (1997)).

PSKS's defense of the *per se* rule was supported by five amici, including, *inter alia*, the American Antitrust Institute and thirty-seven states. PSKS asserted that the alleged procompetitive effects of RPM agreements cited by Leegin were based on mere theory with no legitimate empirical support. On the other hand, PSKS argued, the anticompetitive effects of such agreements are obvious, because they prevent sellers from lowering their prices when they otherwise would choose to do so.

## The Court's Decision

In a 5-4 opinion written by Justice Kennedy, the Court overruled Dr. Miles and held that vertical price restraints are to be judged henceforth by the rule of reason. The Court began its analysis by noting that restraints on trade should be subject to a rule of reason analysis unless the restraint "would always or almost always tend to restrict competition and decrease output." *Leegin*, 551 U.S. __, at *6 (quoting *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988)). Dr. Miles declared RPM agreements illegal *per se*, however, based not on an economic analysis of the practice but largely on "the common-law rule against restraints on alienation." *Id.* at *7. The Court explained that"[t]he reasons upon which Dr. Miles relied do not justify a *per se* rule. As a consequence, it is necessary to examine, in the first instance, the economic effects of vertical agreements to fix minimum resale prices, and to determine whether the *per se* rule is nonetheless appropriate." *Id.* at *8-9.

Citing various amici briefs, the Court stated that "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance." *Id.* at * 9. The possible procompetitive effects of RPM agreements include the stimulation of interbrand competition, increased consumer choice between low-price, low-service brands and high-price, high-service brands, and the elimination of free-riding retailers who under-price high-service retailers without providing the same level of service themselves. *Id.* at *9-11. RPM agreements can also increase ease of market entry for new manufacturers by encouraging robust investment of capital and labor necessary for the distribution of products unknown to the consumer.

The Court acknowledged that RPM agreements can have anticompetitive effects as well, such as the facilitation of cartel price-fixing. These possible anticompetitive effects, however, do not establish that RPM agreements "always or almost always tend to restrict competition and decrease output." *Id.* at *14 (citing *Business Electronics*, 485 U.S. at 723). Nor, the Court claimed, was there sufficient evidence that RPM agreements inevitably lead to higher retail prices. Various factors affect retail prices, and manufacturers can be expected to set minimum resale prices only if the "increase in demand resulting from enhanced service . . . will more than offset a negative impact on demand of a higher retail price." *Id.* at *17 (citing *Mathewson & Winter, The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998)). In evaluating RPM agreements, courts will "have to be diligent in eliminating their anticompetitive uses from the market." *Id.* at *17.

The Court expressly rejected PSKS's argument that RPM agreements "can lead to higher pricing", characterizing this reliance on price effects as "mistaken . . . absent a further showing of anticompetitive conduct." *Id.* at *15-16. As the Court noted, "[m]any decisions a manufacturer makes and carries out through concerted action can lead to higher prices." *Id.* at *17. The Court concluded that the per se rule for RPM agreements is a "flawed antitrust doctrine that serves the interests of lawyers — by creating legal distinctions that operate as traps for the unwary — more than the interests of consumers — by requiring manufacturers to choose second-best options to achieve sound business objectives." *Id.* at *25.

Subjecting RPM agreements to a rule of reason analysis is also in harmony with the Court's treatment of other forms of vertical restraints in *United States v. Colgate & Co.*, 250 U.S. 300 (1919) and *GTE Sylvania,* 433 U.S. 36. The Court acknowledged that these cases "permit manufacturers to secure the procompetitive benefits associated with vertical price restraints through other methods." *Leegin*, 550 U.S. ___ at *23. The *Leegin* decision is a necessary addition to this body of law because these other methods "could be less efficient." *Id.*

This case continues the Roberts Court's struggles with stare decisis. *Leegin*, quoting Khan, 522 U.S. at 20-21, had argued that *stare decisis* "is not an inexorable command." Rather, the Sherman Act's concept of restraint of trade is dynamic, and must be adapted to "modern conditions." The majority agreed, stating that while "[w]e do not write on a clean slate," the role of *stare decisis* in this case is not as significant because the Sherman Act is a "common-law statute," and "just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act's prohibition on 'restraint[s] of trade' evolve to meet the dynamics of present economic conditions." *Leegin*, 551 U.S. ___, at *19-20.

In holding that *Dr. Miles* should be overturned, the Court demonstrated that it will overturn precedent if a majority of the Justices find it appropriate to do so.[2] Justice Breyer's dissent, which, among other things, wrestles with the factors that should be considered before overruling precedent, suggests, however, that the role of *stare decisis* in the Roberts Court is far from settled.

## What the Decision Means

The *Leegin* decision has clear implications for the retail industry. By striking down *Dr. Miles*, the Court has removed a significant obstacle to manufacturers' ability to control the marketing and distribution of their products. Manufacturers are now free to set minimum resale prices if doing so is reasonably likely to lead to procompetitive consequences. Because RPM agreements are still subject to rule of reason evaluation, however, retailers and consumers retain their protection against anticompetitive RPM agreements. In addition, while the Court has clarified federal law on RPM agreements, state law remains unsettled. RPM agreements may still be deemed to be *per se* illegal under many state statutes, the interpretations of which are not necessarily affected by the *Leegin* ruling.

This decision also demonstrates that the Roberts Court views antitrust policy as a dynamic enterprise that is sensitive to developments in economic theory. The broader implications for the Court's view of *stare decisis*, however, remain unclear.

---

[2] This aspect of the decision is significant in light of the attention generally devoted to the Roberts Court's attitude toward *stare decisis*. For example, Chief Justice Roberts' recently issued opinion in the combined cases of *Federal Election Commission v. Wisconsin Right to Life,* 551 U.S. __, Case No. 06-969, June 25, 2007 and *McCain v. Wisconsin Right to Life*, 551 U.S. __, Case No. 06-970, June 25, 2007 arguably overruled *McConnell v. Federal Election Commission*, 540 U.S. 93 (2003) without saying so; this was sharply criticized by Justice Scalia in a dissenting footnote in that case as "faux judicial restraint." *Wisconsin Right to Life,* 551 U.S. __ at *17 n.7. And Scalia himself joined earlier in the Term in the majority opinion in *Gonzales v. Carhart*, which can also be read as having overruled precedent without saying so. 550 U.S. __, Case No. 05-380, April 18, 2007.




**Colin A. Underwood**
212.969.3350 – cunderwood@proskauer.com

**Ronald S. Rauchberg**
212.969.3460 – rrauchberg@proskauer.com

**Michael S. Lazaroff**
212.969.3645 – mlazaroff@proskauer.com