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How Wide Did the Supreme Court Open The Door to Minimum Resale Pricing?

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For almost 100 years, the antitrust laws strictly prohibited a supplier and its dealer from agreeing on a minimum resale price. This bright-line rule changed in June when the U.S. Supreme Court held in *Leegin v. Creative Leather Products Inc. v. PSKS Inc.*[1] that such minimum resale price maintenance agreements cannot be condemned automatically and must instead be evaluated on a case-by-case basis. With this decision, the court overruled *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[2] which had held that minimum resale price arrangements are per se illegal under Section 1 of the Sherman Act.[3]

In *Leegin* the court was asked to lift the per se ban against minimum resale price maintenance in light of a growing body of economic evidence about the restriction's actual effects on consumers and overall competition. After reviewing those economic arguments — pro and con — the five-member majority was persuaded that setting a minimum resale price does not always harm competition and, accordingly, held that the case-by-case approach under the rule of reason should now apply.

Under the rule of reason, all circumstances are considered and weighed to determine if a practice unreasonably restrains competition. Thus, post-*Leegin*, courts must consider the business justifications and economic evidence of the minimum resale price arrangement, and they can only impose liability when the plaintiff shows that the arrangement's adverse effects on competition outweigh its pro-competitive benefits.

The per se prohibition on minimum resale price maintenance in effect since *Dr. Miles* had been the subject of vigorous debate not only among economists, but also the business community and state and federal legislators and regulators. It is no surprise that *Leegin* was closely watched, with more than a dozen *amici* submitting briefs, split almost evenly in support of or urging the reversal of *Dr. Miles*.

It should also be no surprise that the four dissenting justices warned that the overturning of *Dr. Miles* and removal of the strict prohibition against minimum resale price maintenance would "create considerable legal turbulence" as suppliers and dealers seek to implement such price controls, and they are challenged in the lower courts.

While *Leegin* does not immunize minimum resale price arrangements, the decision requires courts to evaluate them within a broader context. The opinion changes the focus of the analysis from the simple question of whether there was an "agreement" to set minimum resale prices to a judgment about the actual competitive effects of the arrangement.

The revised approach will not end litigation over such arrangements (and may lead to increased litigation in the short run). But with careful consideration of the business reasons and potential customer benefits, suppliers can add minimum resale price features to their distribution programs with reduced risk of antitrust liability. With these concepts in mind, we analyze *Leegin* and the guideposts it offers to companies (and their counsel) that are considering implementation of a minimum resale price program.

Facts of the Case

Leegin Creative Leather Products was a designer and manufacturer of leather goods and accessories sold under the Brighton brand name. Leegin had a dual distribution network, selling Brighton products in about 70 of its own stores and to about 5,000 independently operated retailers. One of these retailers was PSKS Inc., which operated a women's apparel store called Kay's Kloset.[4]

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Leegin's marketing strategy focused on sales through boutique retailers. Its management believed that boutiques provided a degree of customer service commensurate with the quality of Brighton goods. In pursuit of this strategy, Leegin set suggested prices and eventually implemented a policy of refusing to sell to retailers that discounted Brighton products below these prices.

According to Leegin, price discounting tarnished the products' image. Adherence to minimum prices also ensured that each retailer earned sufficient margin on Brighton goods to invest in providing quality customer service.[5]

For several years Kay's Kloset followed Leegin's product pricing rules. But after learning that other Brighton retailers were discounting from the suggested prices, Kay's Kloset also started cutting prices. When Kay's Kloset continued discounting, Leegin stopped shipping to the store.[6]

Kay's Kloset responded by filing federal antitrust claims in the U.S. District Court for the Eastern District of Texas. Among other theories, Kay's Kloset alleged that Leegin had been engaged in prohibited minimum resale price maintenance.

At trial Leegin attempted to introduce expert testimony describing the pro-competitive benefits of its pricing strategy. According to Leegin, its program was intended to enable its Brighton line and its smaller retailers to compete against more prominent brands sold by national retailers. Leegin argued that while its resale price maintenance program was in effect, sales of Brighton products increased.[7]

However, the District Court excluded the expert evidence as irrelevant, reasoning that the agreement alleged by Kay's Kloset, if shown to exist, would be per se unlawful under the rule of *Dr. Miles*. At trial, the jury found for Kay's Kloset and awarded compensatory damages of $1.2 million stemming from the loss of the Brighton line.

The U.S. Court of Appeals for the 5th Circuit affirmed, rejecting Leegin's argument that the District Court erred by excluding consideration of its expert evidence at trial.

The Supreme Court's Analysis

The Supreme Court granted *certiorari* to address the single question of whether "vertical minimum resale price maintenance agreements should continue to be treated as per se unlawful." The five-member majority of Chief Justice John Roberts Jr. and Justices Anthony Kennedy, Antonin Scalia, Clarence Thomas and Samuel Alito said no.

The Majority's View

The court's opinion, written by Justice Kennedy, followed two branches. In the first, the majority determined that the rationale underlying the 1911 decision of *Dr. Miles* was aged and had little continuing value given the many changes in retailing, distribution and the overall economy during the last century. In the second, the majority was persuaded by a long-building body of economic and legal research showing that minimum resale price maintenance can, in fact, enhance efficiency and consumer welfare. Thus, the strict ban on the practice — embodied in the per se treatment of *Dr. Miles* — no longer was appropriate, and courts must take a case-by-case approach under the rule of reason.

The majority noted that the vitality of *Dr. Miles* rested in great part on the common-law rule against alienation. Not only was this common-law doctrine ancient, dating to the 1600s, it concerned restrictions on the resale of real property, not personal property.[8] The majority also recognized that, since *Dr. Miles*, federal antitrust law had evolved to treat vertical relationships between suppliers and dealers with less suspicion, no longer putting them on the same plane as horizontal agreements between competing suppliers or competing dealers.[9] Instead, the majority expressed concern about the difficulties of navigating the existing antitrust regime, in which *minimum* resale price maintenance was strictly prohibited under *Dr. Miles*, but other vertical restrictions, such as territorial limitations on dealers and even *maximum* resale price maintenance, are subject to a rule-of-reason inquiry.[10]

In particular, the majority discussed the tension between *Dr. Miles*'s strict rule against suppliers and dealers agreeing on a minimum resale price and the "*Colgate* doctrine" that permits a manufacturer to unilaterally refuse to deal with a retailer that does not follow the manufacturer's suggested minimum price.[11] While the economic effects are generally the same, the combination of a per se rule against an "agreement" to maintain minimum resale prices and the ability of a supplier to "unilaterally" refuse to deal with retailers that discount below the supplier's "suggested" prices could hinder efficiency and competition and result in incorrect jury verdicts.[12] Treating all supplier-dealer arrangements the same way would eliminate those "legal distinctions that operate as traps for the unwary."[13]

Turning to the body of academic analysis, the majority explained that the "economics literature is replete with pro-competitive justifications for a manufacturer's use of resale price maintenance."[14] The majority, while

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recognizing the potential anticompetitive dangers of resale price maintenance, pointed to studies showing that such arrangements can promote upstream competition between manufacturers selling competing brands of goods — "interbrand competition." An ensured minimum retail price provides the economic incentive to dealers as retailers to invest in services and promote their supplier's products, which in turn serves to expand consumer demand. Without the ability to have the supplier control resale price, retailers would be reluctant to promote goods out of concern that a low-price discounter will free ride on those efforts.[15]

The majority also found merit in the argument that control of the resale price, and the attendant security to dealers of an adequate margin, may enhance a supplier's ability to attract "competent and aggressive" dealers to market its product.[16] This could serve to expand the number of competitors and amount of output. In light of these potential competitive benefits, the majority concluded that the *Dr. Miles* rule deeming all resale price arrangements per se unlawful was no longer justified.

Finally, noting that it did "not write on a clean slate," the majority determined that *stare decisis* did not prevent the overruling of the *Dr. Miles* rule in light of the economic and other reasons to reject a per se rule.[17]

The Dissent's View

Led by Justice Stephen Breyer, the four dissenting justices disputed that an adequate case had been made to overturn *Dr. Miles*. On the economics, the dissent acknowledged that it would be a difficult question to decide whether a per se rule or a rule-of-reason approach should be employed "[w]ere the court writing on a blank slate."[18] However, with *Dr. Miles* on the books and relied upon for almost 100 years, the dissent believed that the principle of *stare decisis* was controlling for several reasons.

First, Congress has, in the dissent's view, tacitly endorsed the *Dr. Miles* rule. For this proposition, the dissent pointed to Congress' repeal of 1930s-era fair-trade legislation that had effectively suspended *Dr. Miles* where a state law allowed suppliers to practice resale price maintenance inside state borders and its failure to amend the Sherman Act to change the *Dr. Miles* rule.[19]

Second, the dissent disagreed that changes in the economy supported reversal of *Dr. Miles*. Justice Breyer did not dispute that the overall economy had seen changes. But he pointed to data showing that the concentration of suppliers and distributors of consumer-oriented goods was one area that had not changed so dramatically.[20] Moreover, the dissent questioned the majority's conclusion that it was difficult for companies to operate under an antitrust regime in which minimum resale price maintenance arrangements were treated differently from other types of vertical restraints.

The dissent noted that the economy had weathered the rule of *Dr. Miles* for nearly a century.[21] Moreover, while the "positive" economic effect of resale price maintenance was debatable, applying the rule of reason under which courts and juries have to consider "complex economic criteria" will lead to a "considerable number of mistakes, which themselves may impose serious costs."[22]

At bottom, the dissent believed that, while economic analysis should inform antitrust law, the potential competitive benefits of minimum resale price maintenance are not sufficiently clear or new to justify "abandoning a well-established antitrust rule."[23]

The Future

As written, the new rule of *Leegin* is limited. The Supreme Court only held that minimum resale price arrangements do not *automatically* violate the Sherman Act and cannot be read to license suppliers and dealers to agree on resale prices with impunity. It did not hold that minimum resale price agreements are per se legal. Nonetheless, *Leegin* certainly opens the door to setting limits on price-discounting.

Leegin may also be read to tacitly endorse the concepts of the economic and business justifications made in favor of jettisoning *Dr. Miles*. Moreover, practically speaking, the risk of liability has been reduced because the potential antitrust plaintiff now has the additional burden of showing — on the merits — that a particular arrangement is anticompetitive. As Justice Breyer ruefully observed in the dissent, without the per se restriction, it is "impractical" for enforcement officials to challenge a practice.[24]

Indeed, one *amicus* claimed: "[A]dopting a rule of reason would make RPM [resale price maintenance] virtually legal. … It is well-known that because of the burdens associated with rule-of-reason litigation, it will be the rare instance where a rule-of-reason RPM case is even brought — no matter how anticompetitive such arrangements might be."[25]

Unquestionably, suppliers and dealers should be cautious when considering whether to implement a minimum pricing policy because only as "courts gain experience considering the effect of these restraints by applying the rule of reason" will there be the necessary "guidance for business."[26] However, the *Leegin* opinion itself and the substantial briefing and commentary surrounding the case offer some insight as to how businesses might begin

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reacting to the Supreme Court decision. Below we offer some questions that companies (and their counsel) should consider when trying to reconfigure a distribution program to make the most of *Leegin*.

Are There Discernable Competitive Benefits Of Providing Higher Margins to Dealers?

Managers should ask themselves why they want to implement a minimum resale price program. What is the business rationale? As a practical matter, the intended effect of a resale price maintenance arrangement is to increase retail prices and, correspondingly, increase dealers' profits. While advocates of the strict ban on resale price maintenance argue that higher prices (paid by consumers) are the *only likely* effects,[27] the majority of the court accepted the argument that increased retail prices and higher dealer profits do not necessarily mean that the arrangement is harmful to overall competition. Instead, the increased retail profits may be directed to purposes that could have a net pro-competitive effect.

Thus, suppliers need to identify the purpose of the programs (the "why") and the specific benefits to consumers or interbrand competition that will result from higher retailer margins (the "effects"). To the extent possible, the program might contractually require retailers to commit to providing these benefits. Examples might include requiring retailers to have certain training programs, longer store hours or even more locations.[28]

The economic and particular market conditions and competitive environment justifying the program should also be identified, analyzed and documented before or contemporaneously with implementation of the program. These forces will differ from industry to industry, market to market and company to company. At bottom, however, the pro-competitive benefits must be real and demonstrable, not abstract or post hoc justifications created to defend a challenge to the program.

Also, if implemented, a minimum resale pricing program, and its business rationale, should be periodically re-examined and re-evaluated to determine the actual effects.

What Is the Company's Market Power?

As with most antitrust issues, market power should be considered in devising a program. The higher the market power of a manufacturer or supplier, the more effect a restraint may have on consumers within that market. A minimum resale price program adopted by a supplier without significant market power is not likely to have a net anticompetitive effect because consumers may turn to other sources of the product in response to higher prices by the supplier implementing the program.

Who Is Asking for Resale Price Protection?

The majority in *Leegin* also suggested that the history of an arrangement can be significant. Where multiple dealers are the driving force of the minimum resale price arrangements, it might simply be a tool that serves cartel-like behavior among dealers and may not enhance interbrand competition. While there is the option of using a *Colgate* type of unilateral pricing policy, that course can be disruptive and stilting of supplier-dealer communications and relationships.

What Are Other Suppliers Doing?

The majority opinion noted that in conducting a rule-of-reason evaluation of a resale price maintenance arrangement, "more careful scrutiny" is appropriate if the practices are widespread among competing manufacturers in a particular industry. The conduct may then appear cartel-like among the suppliers. The economic concern is that if resale price maintenance prevails across all suppliers of a given product line, consumers may be harmed due to a lack of access to any low-cost product.

Are Suppliers Also Involved in Distribution?

Federal Trade Commissioner Pamela Jones Harbor submitted an "open letter" to the Supreme Court about *Leegin*, expressing concern that minimum resale pricing arrangements may disguise horizontal agreements between competing retailers. Harbor argued that the facts of the case did not justify resale price maintenance because Leegin was not only a supplier, but also a retailer. Thus, it was possible that Leegin "crafted a horizontal price-fixing agreement to protect its own stores from competition with other retailers."[29] It is not known how courts will treat minimum resale price maintenance within the dual-distribution context, as the Supreme Court did not address this point.

What Will State Regulators Do?

This might end up being the most important question of all. Regardless of *Leegin*'s import to federal antitrust law, the states have their own antitrust enforcement authority. Thirty-seven states, led by New York, argued that the rule of *Dr. Miles* should be upheld. In their *amici* brief in the *Leegin* case, these states highlighted that they "vigorously prosecuted cases" involving resale price and agreements.[30]

Although federal antitrust law often determines the many state "baby Sherman Acts," state law is not uniform on this issue. Some states have case law or statutes that outlaw minimum resale price maintenance or vertical price-fixing. State enforcement agencies and courts may choose to depart from federal precedent and continue to treat minimum resale price arrangements as strictly illegal.[31]

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Thus, despite *Leegin*, the risk of a per se attack on a minimum resale price arrangement by a state regulator or in a state law private action remains and should not be ignored.

Conclusion

Although the overturning of *Dr. Miles* and the relaxing of antitrust scrutiny has opened the door to supplier minimum price policies and programs, we do not yet know how wide that door has been opened. Suppliers certainly have more flexibility to add a minimum resale price feature to an existing program or create a new program. *Leegin* also brings the minimum price issue in alignment with standards for other vertical arrangements. However, the risk of incurring federal and state antitrust liability remains.

In fact, many believe that there will be more litigation — not less — at least in the short term while courts sort out the contours of the rule-of-reason analysis. Rule-of-reason litigation can be expensive, time-consuming and difficult to resolve in a summary fashion. But *Leegin* is a step in the direction toward permitting suppliers more flexibility and consistency in dealing with their reseller customers.

To minimize the risk, companies and their counsel should proceed cautiously, carefully consider the purpose of the arrangements, and document the specific benefits to consumers and interbrand competition of any program they implement.

Notes

[1] 127 S. Ct. 2705 (2007).

[2] 220 U.S. 373 (1911).

[3] 15 U.S.C. § 1.

[4] *Leegin*, 127 S. Ct. at 2710-11.

[5] *Id.* at 2711. *See also* Brief for Petitioner at 23, *Leegin Creative Leather Prods. Inc. v. PSKS Inc.*, No. 06-480 (U.S. Jan. 22, 2007).

[6] *Leegin*, 127 S. Ct. at 2711.

[7] Leegin Brief at 23.

[8] *Leegin*, 127 S. Ct. at 2714.

[9] *Id.*

[10] *Id.* at 2721-22.

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

[12] *Leegin*, 127 S. Ct. at 2722-23.

[13] *Id.* at 2723.

[14] *Id.* at 2714.

[15] *Id.* at 2715-16. An example of "free riding" was described in the *amicus* brief of golf club manufacturer Ping, which urged reversal of *Dr. Miles*. Ping described how some of its dealers were telling customers to visit those Ping dealers that had invested in an optional custom-fitting program sponsored by the manufacturer, obtain their custom specifications and then return to the discounting dealer, which would order the clubs and at a cut-rate price. *See* Brief of Ping Inc. as Amicus Curiae Supporting Petitioner at 7, *Leegin Creative Leather Prods. v. PSKS Inc.*, No. 06-480 (U.S. Jan. 22, 2007).

[16] *Leegin*, 127 S. Ct. at 2715 (citing *Cont'l T.V. Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 [1977]).

[17] *Id.* at 2720-21.

[18] *Id.* at 2726.

[19] *Id.* at 2727-28.

[20] *Id.* at 2733-34 (describing, among other things, that in 1963 the top eight suppliers of household refrigerators had 91 percent of the U.S. market and 95 percent of the market in 2002).

[21] *Id.* at 2734-35.

[22] *Id.* at 2730.

[23] *Id.* at 2734.

[24] *Id.* at 2731.

[25] *See* Brief of Consumer Federation of America as Amicus Curiae Supporting Respondent at 21, *Leegin Creative Leather Prods. v. PSKS Inc.*, No. 06-480 (U.S. Feb. 26. 2007).

[26] *Leegin*, 127 S. Ct. at 2720.

[27] In the view of the American Antitrust Institute, "[t]he function of RPM is to raise resale prices to consumers as there is no dispute that RPM generally has that effect." Brief for American Antitrust Institute as Amicus Curiae Supporting Respondent at 21, *Leegin Creative Leather Prods. v. PSKS Inc.*, No. 06-480 (U.S. Feb. 26, 2007).

[28] *See* Brief of United States as Amicus Curiae Supporting Petitioner at 10-11, *Leegin Creative Leather Prods. v. PSKS Inc.*, No. 06-480 (U.S. Jan. 22, 2007) (describing consumer benefits aside from lower prices).

[29] *See* "Open Letter" from Pamela Jones Harbour, Commissioner, Federal Trade Commission, to U.S. Supreme Court (Feb. 26, 2007), 15.

[30] *See* Brief of New York and 36 States as Amicus Curiae Supporting Respondent at 1, *Leegin Creative Leather Prods. v. PSKS Inc.*, No. 06-480 (U.S. Feb. 26, 2007).

[31] The legal landscape in California illustrates the difficulty of predicting state antitrust law reactions following *Leegin*. Generally, California courts have found the federal courts' interpretation of the Sherman Act to be a helpful aid in construing the state's Cartwright Act. With respect to minimum resale price arrangements, the California Supreme Court has held that such arrangements are per se illegal under the Cartwright Act. *See Mailand v. Burkle*, 572 P.2d 1142, 1148 (Cal. 1978). However, while the state high court reasoned that per se treatment of resale price maintenance found support in the rule of *Dr. Miles*, the court also found that per se treatment of such arrangements was supported by specific language within the Cartwright Act.

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