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# VERTICAL PRICE RESTRAINTS AFTER *LEEGIN*

*Edward D. Cavanagh\**

In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>1</sup> the Supreme Court by a vote of 5-4 overruled the century old *per se* ban on resale price maintenance (“r/p/m”) enunciated in the *Dr. Miles*<sup>2</sup> case. The Court did not rule that r/p/m is lawful *per se* but rather held that vertical price restraints should be adjudged under the broader rule of reason analysis.<sup>3</sup> The decision was not unexpected; and, indeed, it was welcomed in many quarters.<sup>4</sup> From one perspective, *Leegin* is a long overdue ruling that simply

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<sup>1</sup> 127 S. Ct. 2705 (2007).

<sup>2</sup> *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

<sup>3</sup> *Leegin*, 127 S. Ct. at 2720 (“The rule of reason is designed and used to eliminate anticompetitive transactions from the market. This standard principle applies to vertical price restraints.”).

<sup>4</sup> See Thomas B. Leary and Janet L. McDavid, *Should Leegin Finally Bury Old Man Miles?* 21 ANTITRUST 66, 71 (Spring 2007) (“The long-deferred burial of *Dr. Miles* is a necessary first step” to building a consensus that antitrust focus on competitive retailers); see Neal R. Stoll and Shepard Goldfein, *Discount Pricing Act: Direct Rebuke To Leegin*, N.Y.L.J., March 18, 2008 at 3. (*Dr. Miles* “incorrectly imposed similar treatment on horizontal and vertical [minimum resale price maintenance (“MRPM”)] arrangements and overlooked the precompetitive possibilities of MRPM;” Tefft W. Smith, Colin R. Kass and Scott Abeles, *Competition Is Good Again*, Legal Times p. 34 (March 19, 2007) (if manufacturers are free to control distribution, they should also be free to control price); Michael A. Denger and Joshua Lipton, *The Rule of Reason and “Leegin Policies”: The Supreme Court’s Guidance*, 22 ANTITRUST 45 (Fall 2007) (“there are a number of different purposes for which a manufacturer might implement resale price maintenance agreements”); but see Michael A. Lindsay, *Resale Price Maintenance and the World After Leegin*, 22 ANTITRUST 32 (Fall 2007) (cautioning that *Leegin* does not eliminate all legal risks with respect to r/p/m).

brings treatment of r/p/m into line with the treatment of vertical non-price restraints.<sup>5</sup> From another perspective, *Leegin* is a watershed holding which marks a clear departure from prior precedent and shifts the focus of antitrust enforcement away from protection of consumer interests and toward protection of business interests at the expense of consumers.<sup>6</sup> Particularly disturbing from this perspective is the Court's cavalier treatment of prior precedent and its willingness to accept largely theoretical economic justifications for r/p/m in abrogating the *per se* rule.

This article will examine the history of the *per se* rule against r/p/m and the merits of the arguments for and against retaining the *per se* rule in vertical price-fixing cases. It argues that *Leegin* contains significant analytical blind spots, is wrongly decided and that resale price maintenance is almost always harmful to consumers. At the same time, it acknowledges that neither the Supreme Court nor Congress is likely to reinstate the *per se* rule. The article concludes with a proposal made of analysis of r/p/m cases under which a finding of r/p/m will be viewed as presumptively unlawful and will shift the burden onto the defendants to come forward with a persuasive factual showing of actual pro-competitive benefits from r/p/m and that these benefits outweigh any harm to consumers.

## EVOLUTION OF THE LEGAL STANDARDS GOVERNING VERTICAL RESTRAINTS

The courts have had considerable difficulty developing coherent, predictable and workable legal standards governing vertically imposed restraints under the antitrust laws. Unlike

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<sup>5</sup> Leary and McDavid, *supra* note 4 at 70.

<sup>6</sup> Robert Pitofsky, *Are Retailers Who Offer Discounts Really "Knives"?* *The Coming Challenge to the Dr. Miles Rule*, 21 ANTITRUST 61, 62 (Spring 2007) ("one thing is clear about minimum resale price maintenance – if successfully pursued at the retail level, consumer prices will increase"); see Tim Craig, MSRP: *Suggestion or Mandate: Retailing Today*, April 9, 2007, available at [www.RetailingToday.com](http://www.RetailingToday.com):

With all due respect to the institution of the Supreme Court, did the Justices ever consider the fact that overrunning *Dr. Miles* could drive half the retail industry out of business; that it could sound the death knell for national brands; or that, when push comes to shove, the vast majority of American consumers don't care about "more service" when it means having to pay "higher prices?"

horizontal restraints on price and output, which the courts (and economists) have universally condemned as invariably competitive and hence *per se* unlawful,<sup>7</sup> judicial treatment of vertically imposed restraints has been inconsistent and, at times, confusing. Initially, perhaps motivated by the twin desires for consistency and simplicity, the courts treated vertical restraints much as it had treated horizontal restraints.<sup>8</sup> This approach may be viewed as somewhat suspect *ab initio* because it ignores a fundamental distinction between horizontal and vertical restraints: whereas we are rightly suspicious of cooperative agreements among *competitors*, we should not be surprised to find a manufacturer that is looking to get its goods to consumers cooperating with its wholesalers, retailers and other specialists in the chain of distribution. Not surprisingly, the *per se* rules developed in the vertical area would often honor form over substance; and that, in turn, created significant practical problems for businesses in the distribution and sales of their goods.<sup>9</sup> *Per se* treatment of vertical restraints also came under attack in the academic community, which generated a significant body of economic scholarship arguing that vertical restraints have important procompetitive benefits and ought not to be summarily condemned.<sup>10</sup>

At the same time, courts drew a distinction between restraints unilaterally imposed by a manufacturer upon its customers and restraints created pursuant to agreement, concluding that as long as a manufacturer is acting unilaterally, the prohibitions of Section 1 of the Sherman Act do not apply.<sup>11</sup> Nevertheless, the line between lawful unilateral behavior and

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<sup>7</sup> See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221-22 (1940) (horizontal price-fixing agreements are *per se* unlawful).

<sup>8</sup> As the Court in *Leegin* noted, the decision in *Dr. Miles* came on the heels of a massive horizontal conspiracy in the pharmaceutical industry. *Leegin*, 127 S. Ct. at 2717. The *Dr. Miles* holding may well have been influenced by the earlier conspiracy.

<sup>9</sup> See, e.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 378-79 (1967) (legality of vertically imposed territorial restraints should turn on whether seller had parted with title, dominion and risk).

<sup>10</sup> See, e.g., Milton Handler, *The Twentieth Annual Antitrust Review—1967*, 53 VA. L. REV. 1667 (1967); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975); see generally *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 48 n.13 (1977).

<sup>11</sup> *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

unlawful conspiratorial behavior has proven difficult to draw, further muddying the water.<sup>12</sup> What has emerged from the shifting sands of judicial decrees and scholarly commentary is a hodge-podge of jumbled thoughts creating a patchwork quilt of confusing law in the vertical area.

*DR. MILES—THE ACCIDENTAL PER SE RULE?*

*Dr. Miles Med. Co. v. John D. Park & Son Co.* (“*Dr. Miles*”)<sup>13</sup> has historically been cited as the source of the *per se* ban on r/p/m, but how that came about is somewhat of a mystery. *Dr. Miles* itself is not an antitrust case but rather a tortious interference case in which the manufacturers of proprietary, unpatented medicines sued a distributor which had (1) declined to enter into a contract with the manufacturer specifying minimum resale prices; and (2) procured manufacturer’s products from other distributors and retailers by inducing them to violate their distributor agreements with the plaintiff-manufacturer.<sup>14</sup> On defendant’s motion to dismiss, the court denied plaintiff’s bid for an injunction upholding the validity of the contract. The Supreme Court agreed that the contract was unenforceable:

Thus a general restraint upon alienation is ordinarily invalid. “The right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy, which is best subserved by great freedom of traffic in such things as pass from hand to hand . . . .” [citation omitted].<sup>15</sup>

From that language, the courts derived the *per se* rule against r/p/m. The majority in *Leegin* emphasized that the *per se* rule in *Dr. Miles* was based on the ancient rule against restraints on alienation of land and not on the economics of distribution of the goods into the stream of commerce, and suggested that for that reason alone, the *Dr. Miles* holding is suspect.<sup>16</sup> Of course,

<sup>12</sup> See, *infra*, nn. 25-34 and accompanying text.

<sup>13</sup> 220 U.S. 373 (1911).

<sup>14</sup> *Id.* at 394.

<sup>15</sup> *Id.* at 404.

<sup>16</sup> *Leegin*, 127 S. Ct. at 2714 (“The general restraint on alienation,

the fact that a holding is consistent with old, even ancient law does not make that holding a candidate for reversal. Indeed, the majority does not challenge the notion that once a product is sold, the seller cannot prohibit resale.<sup>17</sup> Rather, the majority seems to suggest that the seller has a legally cognizable interest in maintaining the brand image and for that reason, may choose to impose r/p/m.<sup>18</sup>

Curiously, at the time of the *Dr. Miles* decision, the *per se* rule against horizontal price fixing was still in its nascent state. Judge Taft had suggested a *per se* rule in the Sixth Circuit's decision in *Addyston Pipe*<sup>19</sup> a decade earlier but it was not until *Trenton Potteries*, some 15 years after *Dr. Miles*, that the Supreme Court adopted the *per se* ban on horizontal price fixing. *Trenton Potteries*<sup>20</sup> was re-affirmed in *Socony-Vacuum*,<sup>21</sup> and thereafter the *per se* rule against horizontal price-fixing became institutionalized and unassailable.<sup>22</sup> Without much thought and

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especially in the age of when then-Justice Hughes used the term, tended to evoke policy concerns extraneous to the question that controls here. Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations. The Court should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance.”)

<sup>17</sup> A seller may, of course, limit the location from which its dealers sell and may confine the dealer to a specific class of customers. See *GTE Sylvania*, 433 U.S. at 59.

<sup>18</sup> See *Leegin*, 127 S. Ct. at 2715-16.

<sup>19</sup> *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898).

<sup>20</sup> *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

<sup>21</sup> *Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

<sup>22</sup> Although the *per se* rule against horizontal price-fixing is universally accepted today, even this fundamental precept has had a rocky history. Indeed, the first time the issue was before the Supreme Court, Justice Brandeis rejected application of the *per se* rule in *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918). The trial court had ruled that an exchange rule which locked sellers of “to arrive” grain on the Exchange into their offers made at the close of the trading session until the opening of trading the next day, a period of 19½ hours, was *per se* illegal and excluded defendant's evidence of justification. *Id.* at 237-38. Reversing, Brandeis held that the conduct should not be summarily condemned, that the court should consider, the nature, scope and effect of the restraint and then balance procompetitive benefits against anticompetitive effects. *Id.* at 238.

Rather than remanding the matter to the district court and despite the fact that all evidence of procompetitive effect had been excluded by the trial court, the majority reversed and entered judgment for the defendant. *Id.* at 241. Supporting that decision, Brandeis cited a laundry list of benefits created by the new Exchange rules, none of which had anything to do with price-fixing. *Id.* at 239-41. Brandeis had failed to grasp that it was the character of

even less analysis, the courts simply applied the same standards used in horizontal cases to vertical cases.<sup>23</sup> Price-fixing in all forms was seen as pernicious and summarily condemned. Later on, at least for a time, the same approach was taken in cases involving non-price vertical restraints.<sup>24</sup>

### COLGATE

*Colgate*<sup>25</sup> was a criminal matter decided eight years after *Dr. Miles*. Relying on *Dr. Miles*, the government indicted the defendants, alleging that Colgate had engaged in an unlawful "combination" with its wholesalers and retailers to fix the prices at which Colgate products were to be sold to the public.<sup>26</sup> The trial court dismissed the indictment; and the Supreme Court affirmed, stating that "the indictment does not charge Colgate & Co. with selling its products to dealers under agreements which obligated the latter not to resell except at prices fixed by the company."<sup>27</sup> The Court further explained:

The purpose of the Sherman Act is to prohibit monopolies, contracts and combinations which

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the restraint (*i.e.*, horizontal price-fixing), not the degree of the restraint (*i.e.*, how much prices went up) that was of concern under the antitrust laws. It was a rare bad day for Justice Brandeis, and he has been rightfully called to task for his faulty analysis. See ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 41-47 (1978).

Even after *Trenton Potteries* sought to relegate *Chicago Board of Trade* to the boneyard, the Supreme Court again in *United States v. Appalachian Coals*, 238 U.S. 344 (1933) seemed to balk at a *per se* analysis of horizontal price-fixing. There, 137 producers of bituminous coal agreed to appoint an exclusive agent to get the best price for the sale of their coal. *Appalachian Coals*, 238 U.S. at 356, 358. Of course, this tactic meant that producers would not attempt to compete by offering discounts off the best price. Nevertheless, the Supreme Court, citing purportedly unethical practices of pyramiding offers by prospective coal buyers declined to enjoin the arrangement. *Id.* at 364. Like *Chicago Board of Trade*, *Appalachian Coals* cannot be squared with the rule of *Trenton Potteries*. *Appalachian Coals*, like *Chicago Board of Trade*, never overruled, was banished into obscurity by *Socony-Vacuum*. *Appalachian Coals* is probably best understood as a depression-era case that has been confined to its own particular facts, and, like *Chicago Board of Trade*, is not authoritative on the issue of horizontal price-fixing.

<sup>23</sup> See, e.g., *Arnold Schwinn & Co.*, 388 U.S. 365 (1967).

<sup>24</sup> *Id.*

<sup>25</sup> *Colgate*, 250 U.S. 300.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 307.

probably would unduly interfere with the free exercise of their rights by those engaged, or who wish to engage, in trade and commerce—in a word to preserve the right of freedom to trade. *In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to the parties with whom he will deal; and, of course, he may announce in advance circumstances under which he will refuse to sell.* [Emphasis added.]<sup>28</sup>

In so ruling, the Court created a distinction between *lawful* unilateral conduct by a seller and *unlawful* conspiratorial conduct that would bedevil antitrust lawyers and their clients for decades. It was lawful for a trader unilaterally to (1) announce “terms of sale,” including a “suggested” retail price; (2) convey its expectations that customers would adhere to the trader’s wishes; and (3) terminate those who did not, including those who failed to adhere to the suggested retail price.<sup>29</sup> On the other hand, the trader could not by contract or otherwise force its retailers to agree on imposing the manufacturer’s price.<sup>30</sup>

However, the unilateral/conspiratorial distinction proved difficult for the courts to draw. Subsequent cases limited the circumstances in which conduct would be deemed unilateral under *Colgate*. For example, in *United States v. Parke, Davis & Co.*,<sup>31</sup> the Supreme Court ruled that an unlawful combination could be found if the seller goes “beyond mere announcement of his policy and the simple refusal to deal” – lawful under *Colgate* – and “takes affirmative action to achieve uniform adherence.”<sup>32</sup> Another court ruled that actively policing dealers’ resale prices is a sufficient basis to find joint activity.<sup>33</sup> In short, manufacturers had rights under *Colgate* but little room to enforce them. This led the Second Circuit to observe that *Colgate* protections applied only in cases whose facts are “of such Doric simplicity as to be

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 309.

<sup>31</sup> 362 U.S. 29 (1960).

<sup>32</sup> *Id.* at 45.

<sup>33</sup> *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922).



somewhat rare in the days of complex business enterprise.<sup>34</sup>

### GTE/SYLVANIA

In *GTE/Sylvania*,<sup>35</sup> the Supreme Court addressed the question of whether a manufacturer's vertically imposed non-price restraints on its dealers, such as location clauses and customer restrictions, were *per se* unlawful. The Supreme Court had consistently held that *horizontally* imposed territorial restraints were subject to *per se* condemnation.<sup>36</sup> In marked contrast to the r/p/m cases, where the *per se* rule was invoked long before horizontal price restraints were held to be similarly subject to summary condemnation, the non-price vertical cases took years to percolate to the Supreme Court level. It was not until the *White Motor*<sup>37</sup> case in 1962 – thus over a half-century after *Dr. Miles* – that the Court faced the question of whether non-price vertical restraints were *per se* unlawful.

In *White Motor*,<sup>38</sup> the government challenged territorial and customer restrictions that White Motor, a manufacturer of heavy duty trucks, had imposed on its dealers as *per se* illegal, and the trial court granted the government's summary judgment motion. The Supreme Court summarily reversed.<sup>39</sup> Justice Douglas, writing for the Court, stated that *per se* rules were appropriate only in those cases where the courts have sufficient experience with a particular restraint to allow them to conclude categorically that the conduct is so devoid of competitive benefit that detailed analysis of the behavior is unnecessary.<sup>40</sup> Justice Douglas noted that the Court's lack of familiarity with non-price vertical restraints made *per se* standards inappropriate.<sup>41</sup>

Nevertheless, the Antitrust Division continued to press the issue; and, six years later, the Court revisited the non-price vertical restraints in *Schwinn*.<sup>42</sup> A divided (5-2) Court held that

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<sup>34</sup> *George W. Warner & Co. v. Black & Decker Mfg. Co.*, 277 F.2d 787, 790 (2d Cir. 1960).

<sup>35</sup> *GTE Sylvania*, 433 U.S. 36.

<sup>36</sup> *See, e.g., United States v. Topco Assocs., Inc.*, 405 U.S. 596 (1972); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

<sup>37</sup> *White Motor Co. v. United States*, 372 U.S. 253 (1963).

<sup>38</sup> *Id.* at 255.

<sup>39</sup> *Id.* at 264.

<sup>40</sup> *Id.* at 263.

<sup>41</sup> *Id.*

<sup>42</sup> *Arnold Schwinn & Co.*, 388 U.S. 365.

vertically imposed territorial restraints by a seller of goods who had parted with "title, dominion and risk" are *per se* illegal.<sup>43</sup> After *Schwinn*, the law of vertically imposed non-price restraints was consistent with the law of horizontally imposed territorial restraints.<sup>44</sup> Nevertheless, *Schwinn* was subject to harsh criticism in the business community.<sup>45</sup> The *Schwinn* rule honored form over substance in that the legality of vertical restraints turned on their form rather than their substance. Most companies found it preferable to sell their goods in the chain of distribution rather than to retain title, dominion and risk. Thus, their attempts to impose territorial customer restraints would run afoul of the *Schwinn per se* rule. Moreover, academic writers challenged *Schwinn* as economically unsound.<sup>46</sup>

In 1977, the Supreme Court in *GTE/Sylvania*<sup>47</sup> revisited the rule of non-price vertical restraints and overruled *Schwinn*, holding that henceforth vertically imposed territorial restraints will be adjudged under the rule of reason.<sup>48</sup> In so ruling, the Court recognized that a manufacturer's decision to limit *intra*brand competition among its dealers may stimulate more aggressive *inter*brand competition and on balance be procompetitive.<sup>49</sup> To stimulate sluggish sales, Sylvania had shifted its distribution strategy from selling through a network of wholesalers and retailers to selling through a limited number of franchised Sylvania dealers.<sup>50</sup> The new agreements contained location clauses which limited the sites from which a particular franchised dealer could sell Sylvania products.<sup>51</sup> Sylvania thus effectively shielded its newly franchised dealers from local price competition in Sylvania products and hoped that in doing so it would attract "more aggressive and competent retailers" who would achieve stronger sales of Sylvania products in the broader interbrand market for electronics.<sup>52</sup>

Sylvania was unhappy with the performance of Continental TV, its San Francisco retailer. Continental TV was

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<sup>43</sup> *Id.* at 382.

<sup>44</sup> See *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

<sup>45</sup> See, e.g., *Handler*, *supra* note 10 at 1686-88.

<sup>46</sup> See, e.g., *Posner*, *supra* note 10 at 296-97.

<sup>47</sup> *GTE Sylvania*, 433 U.S. 36.

<sup>48</sup> *Id.* at 59.

<sup>49</sup> *Id.* at 54-55.

<sup>50</sup> *Id.* at 38.

<sup>51</sup> *Id.*

<sup>52</sup> *Continental T.V.*, 433 U.S. at 38.

unhappy when Sylvania balked at its request to open a Sacramento store. The dispute escalated, and Continental TV began to withhold payments to Sylvania. Sylvania countered by cutting Continental TV's line of credit by 80% and then suing to recover its accounts receivables. Continental TV responded with an antitrust counterclaim, alleging that Sylvania's location clauses were *per se* illegal under *Schwinn*.

The trial court declined to find the location clauses unlawful; the Ninth Circuit reversed on authority of *Schwinn*.<sup>53</sup> In reversing the Ninth Circuit, the Supreme Court overruled *Schwinn* and held that vertically imposed location clauses must be adjudged under a rule of reason standard.<sup>54</sup> It held that the *Schwinn* rule was analytically unsupportable because the *Schwinn* test turned on the form of the transfer from manufacturer to dealer and there was no proof that the competitive impact of any vertical restriction "is significantly affected by the form of the transaction."<sup>55</sup> In addition, the court cited specific pro-competitive benefits that can be achieved through non-price vertical restriction<sup>56</sup>:

promotion of interbrand competition by enabling the manufacturer to achieve efficiencies in distribution;

facilitation of new product introduction by providing incentives to retailers to invest in and promote products unknown to the consumer;

inducing retailer to create and operate service and repair facilities for manufacturer's products to enhance the good will and competitiveness of those products; and

minimizing free rider problems.

*GTE/Sylvania* was a milestone case from both a substantive and jurisprudential perspective. From a jurisprudential perspective, it marked the first time that the Supreme Court entertained, considered and relied on

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<sup>53</sup> *Id.* at 41-42.

<sup>54</sup> *Id.* at 59.

<sup>55</sup> *Id.* at 54.

<sup>56</sup> *Id.* at 54-56.

sophisticated economic arguments in determining whether a particular restraint or class of restraints had pro-competitive merit. From a substantive perspective, *GTE/Sylvania* harmonized antitrust principles and rational business decisions by manufacturers. Moreover, it virtually eliminated overnight a class of antitrust actions – dealer termination suits – long viewed by the business community as frivolous, but, at the same time, a staple of the national antitrust docket.

*GTE/Sylvania* also re-ignited the debate over r/p/m, although the decision itself unequivocally reiterates the *Dr. Miles* holding.<sup>57</sup> Critics of the *per se* ban on r/p/m argued that the economic effects of vertically imposed price and non-price restraints are indistinguishable.<sup>58</sup> If a seller could insulate a

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<sup>57</sup> *GTE/Sylvania* distinguished vertically imposed territorial restraints from r/p/m and reaffirmed the *per se* ban on vertical price fixing:

As in *Schwinn*, we are concerned here only with nonprice vertical restrictions. The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As Mr. Justice White notes, post, at 2568, some commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in *White Motor Co. v. United States*, Mr. Justice Brennan noted that, unlike nonprice restrictions, "[r]esale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands." Professor Posner also recognized that "industry-wide resale price maintenance might facilitate cartelizing." Furthermore, Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States. No similar expression of congressional intent exists for nonprice restrictions.

433 U.S. at 51 n.18 (citations omitted).

<sup>58</sup> See, e.g., *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883, (1st Cir. 1978) (after *Sylvania*, r/p/m should be adjudged under a rule of reason analysis); see also *Morrison v. Murray Biscuit Co.*, 797 F.2d 1430, 1438 (7th Cir. 1986) (stating after *Sylvania*, the rationale for the *per se* rule against r/p/m is "unclear"); see also Richard A. Posner, *The Next Step in The Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 21 (1981) ("If [the defendant's] output expanded, the restriction must have made the firm's product more attractive to consumers on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition.").

dealer from intrabrand competition, and thereby permit the dealer to charge higher prices, by employing location clauses, then why could a manufacturer not impose r/p/m on its dealer and thereby achieve the same result?<sup>59</sup>

### KHAN

In *State Oil Co. v. Khan*,<sup>60</sup> the Supreme Court re-examined the *per se* ban on vertically imposed *maximum* price-fixing established thirty years earlier in *Albrecht v. Herald Co.*<sup>61</sup> Reversing *Albrecht*, the Court in *Khan* held that "there is insufficient economic justification for *per se* invalidation of maximum price fixing."<sup>62</sup> The Court observed that maximum price-fixing – unlike minimum price-fixing – was likely to lead to low prices and that low prices benefited consumers, provided those prices are above predatory levels.<sup>63</sup> Accordingly, maximum price-fixing was unlikely to harm competition.<sup>64</sup> More importantly, the *per se* ban on maximum price-fixing had the perverse economic effect of encouraging suppliers to integrate forward in the distribution chain and thus eliminate the much smaller dealer that *Albrecht* was intended to protect.<sup>65</sup> At the same time, the Court acknowledged and reaffirmed the *per se* ban on *minimum* price fixing.<sup>66</sup>

### THE LEEGIN DECISION

Leegin manufactured women's belts and other accessories and sold its products in over 5,000 specialty retail stores throughout the United States, including the plaintiff, Kay's

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<sup>59</sup> *Eastern Scientific*, 572 F.2d at 886.

<sup>60</sup> 522 U.S. 3 (1997).

<sup>61</sup> 390 U.S. 145 (1968). In *Albrecht*, a St. Louis newspaper imposed maximum resale price maintenance on its dealers. In setting a maximum price, the newspaper hoped to maximize circulation and to make sure that dealers, whose territories were exclusive, did not gouge customers. Nevertheless, the Court held that maximum r/p/m was unlawful, ruling that agreements to fix maximum prices "no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." *Id.* at 152 (citation omitted).

<sup>62</sup> *Khan*, 522 U.S. at 18.

<sup>63</sup> *Id.* at 15.

<sup>64</sup> *Id.* at 17-18.

<sup>65</sup> *Id.* at 16-17.

<sup>66</sup> *Id.* at 11.

Kloset.<sup>67</sup> In addition, Leegin sold its products through some 70 stores that it owned in whole or in part, including a store that was in competition with the plaintiff.<sup>68</sup> Leegin engaged in resale price maintenance and terminated the plaintiff after it learned that plaintiff had been discounting.<sup>69</sup> Plaintiff won a jury verdict, which was later affirmed by the Fifth Circuit.<sup>70</sup>

Ignoring Leegin's horizontal relationship with the plaintiff and other retailers, the Supreme Court reversed and, overruling *Dr. Miles*, held that henceforth r/p/m arrangements must be adjudged under a full-blown rule of reason analysis.<sup>71</sup> First, the Court observed that the legal basis for *per se* condemnation of r/p/m in *Dr. Miles* was shaky from the beginning.<sup>72</sup> *Per se* rules have been applied only where the restraint in question always or almost always restricts competition and reduces output.<sup>73</sup> In *Dr. Miles*, however, the Court did not condemn r/p/m as *per se* unlawful on that basis.<sup>74</sup> Rather, the Court relied on the common law rule against restraints on alienation.<sup>75</sup> The *Leegin* Court found that the *Dr. Miles* holding was based on "'formalistic' legal doctrine rather than 'demonstrable economic effect'" and hence was irrelevant to the issue before it.<sup>76</sup> Moreover, *Dr. Miles* treated vertical restraints on price as analogous to horizontal restraints, an approach which has been uniformly rejected in subsequent cases.<sup>77</sup> In short, the *Dr. Miles* rationale does not justify imposition of the *per se* rule.

Second, the Court found that r/p/m is not invariably anticompetitive and that the "economic literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."<sup>78</sup> The Court cited the following procompetitive benefits from r/p/m:

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<sup>67</sup> *PSKS, Inc. v. Leegin Creative Leather Prods., Inc.*, 171 F. App'x. 464, 465 (5th Cir. 2006).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 466.

<sup>70</sup> *Id.* at 470.

<sup>71</sup> *Leegin*, 127 S. Ct. at 2713-14.

<sup>72</sup> *Id.* at 2714.

<sup>73</sup> *Id.* at 2713.

<sup>74</sup> *Id.* at 2714.

<sup>75</sup> *Id.*

<sup>76</sup> *Leegin*, 127 S. Ct. at 2714.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

*Promotion of interbrand competition.*<sup>79</sup>

Use of r/p/m to limit intrabrand competition “encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer’s position as against rival manufacturers in the interbrand market.”<sup>80</sup>

*Encouraging retailers to provide services and preventing free riding.*<sup>81</sup>

Absent r/p/m, retailers may be reluctant to provide services for a given product because they fear that discounters may free ride off their expenditures. R/p/m obviates this problem by preventing a discounter from undercutting the retailer providing services.<sup>82</sup>

*Encouraging entry of new firms and brands.*

Manufacturers entering a new market can use r/p/m to induce their retailers to invest substantially in the new product in order to bring it to the attention of consumers.<sup>83</sup>

*Encouraging retailers to provide extra services.*<sup>84</sup>

In addition to encouraging retailers to provide promotional and advertising services, r/p/m can be used by retailers to provide other services to assist a manufacturer in building market share, such as keeping adequate inventories of a manufacturer’s goods in the face of uncertain demand.<sup>85</sup>

Surprisingly, the Court’s opinion did not emphasize a rationale for r/p/m frequently proffered by manufacturers – concern that discounting may tarnish a brand’s image.<sup>86</sup> Higher

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<sup>79</sup> *Id.* at 2715.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 2715-16.

<sup>82</sup> *Leegin*, 127 S. Ct. at 2716.

<sup>83</sup> *Id.* at 2716.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.* at 2711. The Court does note that defendant was concerned that plaintiff’s discounting was tarnishing defendant’s brand image. *See generally*, Joseph Pereira, *Price Fixing Makes A Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1 (“Manufacturers like [r/p/m] partly because discounts can tarnish a brand’s image. ‘We don’t want consumers to think

prices give a product certain cachet that may be undermined by discounting, and retailers have greater incentive to promote price-protected goods.<sup>87</sup> However, protection of a product's snob appeal has never been a goal of the antitrust laws. The true test of a product's worth is its reception in the marketplace. R/p/m effectively denies consumer choice by denying the consumer opportunity to purchase from a discounter or a full-service retailer.<sup>88</sup>

While acknowledging potential anticompetitive effects of r/p/m, the Court concluded that "it cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tend[s] to restrict competition and decrease output.'"<sup>89</sup> The Court emphasized that r/p/m can have either procompetitive or anticompetitive effects and that imposition of a *per se* rule against r/p/m creates the risk of harm to consumers "by prohibiting procompetitive conduct that the antitrust laws should encourage."<sup>90</sup>

Nor was the Court moved by arguments that r/p/m invariably leads to higher retail prices:

Respondent's argument, furthermore, overlooks that, in general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins. The difference between the price a manufacturer charges retailers and the price retailers charge consumers represents part of the manufacturer's cost of distribution, which like any other cost, the manufacturer usually desires to minimize.<sup>91</sup>

The courts can deal with those cases where r/p/m presents a threat to competition on a case by case basis.<sup>92</sup>

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we're the cheapest guys in the world,' says Ray Minoff of L.K. Kichler, the lighting maker.")

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* ("Critics argue the policies undermine the free market by limiting shoppers' power to decide for themselves whether to, say, buy at rock-bottom price from a no-frills outlet, or pay full price to someone offering better service or other benefits.")

<sup>89</sup> *Leegin*, 127 S. Ct. at 2717 (citing *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988)).

<sup>90</sup> *Id.* at 2717-18.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 2718.



In addition, the Court rejected the argument that *stare decisis* requires that *Dr. Miles* be affirmed.<sup>93</sup> As a threshold matter, the Court found that *stare decisis* was not a significant concern in this case because the Sherman Act has always been treated by the Court as a common law statute, which adapts to the modern understanding of the law.<sup>94</sup> The Court found that the *per se* ban on r/p/m is no longer supportable, noting that the Justice Department and the FTC had rejected a *per se* approach and that cases subsequent to *Dr. Miles* have eroded its doctrinal underpinnings.<sup>95</sup> The Court also ruled that application of the rule of reason to r/p/m cases will clarify the law by harmonizing the rules in cases involving vertical price and vertical non-price restrictions.<sup>96</sup> The Court concluded:

In sum, [the *per se* ban on r/p/m] is a flawed legal doctrine that serves the interest of lawyers – by creating legal distinction 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.<sup>97</sup>

Finally, the Court made short-shrift of plaintiff's argument that Congress had implicitly embraced the *per se* rule by repealing the Fair Trade Laws<sup>98</sup> and that a strong reliance interest called for the imposition of *stare decisis*.<sup>99</sup> At the end of the day, the Court found that r/p/m has been utilized in only a small sector of the economy and that to the extent consumers demand cheap goods, application of the rule of reason in r/p/m cases will not prevent the market from supplying them.<sup>100</sup>

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<sup>93</sup> *Id.* at 2720.

<sup>94</sup> *Leegin*, 127 S. Ct. at 2720.

<sup>95</sup> *Id.* at 2721.

<sup>96</sup> *Id.* at 2723.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 2723-24.

<sup>99</sup> *Leegin*, 127 S. Ct. at 2723-24.

<sup>100</sup> *Id.* at 2725. While it may be that r/p/m was rare prior to *Leegin*, perhaps because it was unlawful *per se*, it is clear that post-*Leegin* r/p/m is becoming more widespread. See, Pereira, *supra* note 86 (detailing renewed efforts of manufacturers to impose prices in the wake of *Leegin*.)

*LEEGIN WAS WRONGLY DECIDED**R/P/M Is Almost Always Detrimental to Consumer Interests*

The *Leegin* opinion is riddled with analytic shortcomings and doctrinal blind spots. As a threshold matter, the Court simply refused to acknowledge that *Leegin* competed directly with some retailers, including the plaintiffs, and that the case therefore had significant horizontal elements calling for *per se* analysis. However, even if viewed on the terms of engagement outlined by the Supreme Court, the decision still cannot withstand scrutiny. First, the Court elides over the fundamental reality that r/p/m invariably results in higher prices to consumers and therefore is not in the consumer interest. Second, it justifies r/p/m on the basis of theoretical (and largely undemonstrated) economic benefits of vertical price fixing. Third, the *Leegin* decision is at odds with the fundamental tenets of *stare decisis*, overruling 100 year old precedent, not on the basis of “new learning” but rather in reliance on recycled arguments that had been around for decades and had been consistently rejected by the courts.

The Supreme Court was wrong in overruling *Dr. Miles* and thereby abrogating the *per se* ban on r/p/m. As the Court itself notes, the *per se* analysis is appropriate where the “restraint would always or almost always tend to restrict competition and decrease output.”<sup>101</sup> The Court then rejects the *per se* analysis because “the economic literature is replete with procompetitive justification for a manufacturer’s use of resale price maintenance.”<sup>102</sup> Nevertheless, the mere fact that one can identify procompetitive benefits from a course of conduct does not eliminate that conduct from *per se* scrutiny. If that were the case, the *per se* rule could not exist. There are exceptions to every rule. One could argue plausibly that the Court’s upholding of a blanket license in *BMI*<sup>103</sup> is an exception to the ironclad rule against horizontal price-fixing. Again in *NCAA*,<sup>104</sup> the Court declined to invoke the *per se* rule, while at the same time acknowledging that the NCAA’s limitations on the rights of

<sup>101</sup> *Leegin*, 127 S. Ct. at 2713 (citing *Bus. Elecs. Corp.*, 485 U.S. at 723).

<sup>102</sup> *Id.* at 2714.

<sup>103</sup> *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 24-25 (1979).

<sup>104</sup> *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 108 (1984).

member institutions to sell television rights to college football games was a "naked restriction on price or output."<sup>105</sup> As Professor Pitofsky observes, the key to the *per se* analysis is that the conduct "almost always results in serious anticompetitive consequences which is almost never justified for business reasons."<sup>106</sup> Thus, the mere fact that one could identify a situation in which a *per se* rule would produce an undesirable result is not a persuasive reason for abandoning the rule in other situations where its results are sound.

The *per se* rule is firmly entrenched in antitrust jurisprudence.<sup>107</sup> By its very nature, the *per se* rule has a degree of arbitrariness.<sup>108</sup> It is nevertheless justified in those cases where experience has taught the courts that the harm to competition from the conduct alleged is substantial and almost always far outweighs any benefits therefrom.<sup>109</sup> At its root, it is a very practical rule of evidence serving to (1) simplify trials; (2) provide for efficient prosecution and administration of antitrust claims; and (3) create bright-line rules that promote certainty and predictability for the business community.<sup>110</sup>

Without the *per se* rule, the courts would be left to adjudge r/p/m under the broader Rule of Reason standard enunciated in *Chicago Board of Trade*. That creates two distinct problems. First, courts would be saddled with the difficult task of weighing destruction of one section of the economy against promotion of competition in another section.<sup>111</sup> While courts are far more attuned to economic issues today than they were a generation ago, that task of balancing interests between sellers and consumers remains daunting; and, frankly, the courts have not done a very good job in that area. The problem is not in identifying beneficial procompetitive activity but rather in weighing that conduct against anticompetitive effects. *Chicago Board of Trade* and its progeny provide no guidance in this respect.<sup>112</sup> Once procompetitive effects are identified and found

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<sup>105</sup> *Id.* at 109.

<sup>106</sup> Robert Pitofsky, *In Defense of Discounters; The No-Frills Case for a Per Se Rule Against Vertical Price-Fixing*, 71 GEO. L.J. 1487, 1489 (1983).

<sup>107</sup> *United States v. Topco Assocs.*, 405 U.S. 596, 608-09 (1972).

<sup>108</sup> *United States v. Container Corp.*, 393 U.S. 313, 341 (1969) (Marshall, J. dissenting).

<sup>109</sup> *Topco*, 405 U.S. at 607-08.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 609-10.

<sup>112</sup> Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 12 (1984).

not to be pretextual or frivolous, defendants generally prevail. The reality is that courts do very little actual balancing of procompetitive benefits against harms to the consumer.

Second, given the judicial reluctance to balance the interests of sellers and consumers, invocation of the broader rule of reason analysis in r/p/m cases has distinct distributive effects favoring defendants. Once the *per se* approach is abandoned, plaintiffs find it virtually impossible to prevail on the merits. There are a handful of notable exceptions—*NCAA*<sup>113</sup> and *Indiana Fed'n of Dentists*,<sup>114</sup> among others—but the fact remains that in the overwhelming majority of cases decided under the rule of reason, defendants prevail. For example, under *GTE/Sylvania*, vertically imposed territorial restraints are subject to the rule of reason analysis, but in 30 years since *GTE/Sylvania*, very few courts have condemned such practices.<sup>115</sup> It defies logic that these outcomes are directly related to the merits in every case. The courts, in purporting to apply a nominal rule of reason, have substituted a *de facto* rule of *per se* legality.

A similar fate awaits r/p/m, even though r/p/m remains an excellent candidate for *per se* treatment. R/p/m invariably leads to higher prices for consumers.<sup>116</sup> Price is the “central nervous system of the economy.”<sup>117</sup> Interference with the price mechanism by private agreement artificially inflates prices to the detriment of consumers. Nevertheless, the Supreme Court in *Leegin* cast a blind eye to this fact, stating that, contrary to common sense and

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<sup>113</sup> *NCAA*, 468 U.S. 85.

<sup>114</sup> *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986).

<sup>115</sup> See *supra* notes 44–56 and accompanying text.

<sup>116</sup> See T. OVERSTREET, *RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE*, 160 (1983); *Hearings on H.R. 2384 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary*, 94th Cong., 1st Sess. (1975) [hereinafter *Hearings*] (statement of Hon. Peter Rodino, Chairman of the House Judiciary Committee) (“The one thing we know for certain these [Fair Trade] laws do is increase prices to the consumer artificially and in violation of the fundamental market principles of a free economy.”). It has been estimated that elimination of resale price maintenance could save American consumers between \$1.5 and \$3 billion per year. *Hearings* at 122 (statement of Keith I. Clearwaters, Deputy Assistant Att’y Gen., Antitrust Division) (prices in states which had adopted Fair Trade Laws, thereby legalizing r/p/m, had increased by 19% to 27% over prices states that did not permit fair trade). See also PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW*, ¶ 164ob at 40 (2d ed. 2000) (noting that r/p/m tends to yield higher consumer prices than would otherwise be the case). See *infra* note 123.

<sup>117</sup> *Socony-Vacuum Oil Co.*, 310 U.S. at 224 n.59.

available empirical data, that the impact of r/p/m is indeterminate.<sup>118</sup> The Court further argues that, in any event, it is not in the manufacturer's interest to set resale prices at levels higher than those in the interbrand market.<sup>119</sup> In other words, in setting resale prices, the manufacturer is acting as a surrogate for the consumer. This argument smacks of putting the fox in the chicken coop to protect the hens. Moreover, the manufacturer's interests are more clearly aligned with the retailers, and not with the consumers. Manufacturers rely on retailers to stock their goods and get them to consumers. It is the retailers who must be pleased in the first instance.

The Court minimizes the significance of r/p/m, noting that only a small percentage of manufacturers employ r/p/m and that accordingly r/p/m is not a significant threat to the economy.<sup>120</sup> Quite to the contrary, the fact that r/p/m is not widespread is a reason that *per se* analysis ought to apply because if this conduct is so rare, it is not worth the court's time to weigh anticompetitive effects against procompetitive benefits. Moreover, the fact that r/p/m is not widely utilized might suggest to businesses that r/p/m is not in the interest of the consumer. Indeed, a trip to Costco or Wal-Mart on any given day will demonstrate that the *vox populi* favors discount shopping over price-fixed shopping.

### *The Court Ignores The Experience Under Fair Trade*

More importantly, in rescinding the *per se* rule in r/p/m cases, the Court ignores four decades of experience under Fair Trade Laws.<sup>121</sup> These Depression-era statutes, designed to protect small businesses from annihilation by large chain stores during the prolonged economic slump brought on by the stock market crash of 1929, authorized states to enact r/p/m statutes, thereby creating an exception to the rule of *Dr. Miles*. In theory, the Fair Trade terms provide the perfect laboratory for testing the pro-competitive benefits of r/p/m. If r/p/m promoted competition, its fruits would have been evident during the 40-year reign of fair trade.

In reality, the Fair Trade Laws were an unqualified disaster and eventually were repealed by the Ford

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<sup>118</sup> *Leegin*, 127 S. Ct. at 2714-15.

<sup>119</sup> *Id.* at 2718.

<sup>120</sup> *Id.* at 2725.

<sup>121</sup> McGuire Act, 66 Stat. 631 (1952); Miller-Tydings Fair Trade Act, 50 Stat. 693 (1937).

Administration.<sup>122</sup> Fair Trade Laws did produce higher prices but none of the benefits associated with r/p/m by its proponents.<sup>123</sup> There is virtually no evidence that Fair Trade fostered additional point-of-sale services, eliminated free riding or facilitated new product introduction. Indeed, when one reviews the products that were typically “fair traded” – over-the-counter pharmaceuticals, shampoo, blue jeans, ammunition, underwear – it is readily apparent that none of the arguments favoring r/p/m even apply.<sup>124</sup>

The Court refuses to acknowledge that through Fair Trade, r/p/m has been tried and failed miserably. Nor does the Court cite any recent scholarship to support its position. This is not to suggest that there is no legal scholarship supporting the Court’s decision.<sup>125</sup> There is, but the insights offered are not new; the Court simply trots out the same justifications that were rejected by Congress in repealing Fair Trade Laws over 30 years ago. Fair Trade brought higher prices to consumers without any tangible benefits. The *Leegin* opinion offers no hope that a new r/p/m regime would be any different.

### *Justifications for R/P/M Are More Theoretical Than Real*

The Court in *Leegin* asserted that r/p/m may be justified on the following grounds: (1) promotion of interbrand competitors; (2) giving retailers financial incentives to provide services and to prevent free-riding; (3) promotion of entry; and (4) to encourage retailers to provide additional services beyond promotion and advertising.<sup>126</sup> As shown below, these “benefits” are more theoretical than real.

#### Interbrand Competition

Use of r/p/m to enhance interbrand competition is another way of describing elimination of competition in the intrabrand

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<sup>122</sup> Consumer Goods Pricing Act of 1975, 89 Stat. 801 (1975).

<sup>123</sup> *Hearings, supra* note 116 at 102 (statement of Senator Brooke estimated the cost of Fair Trade Laws to consumers to be \$3 billion). Justice Breyer suggested that the *Leegin* decision would cost American consumers \$300 billion. *Leegin*, 127 S. Ct. at 2735 (Breyer, J. dissenting); *see supra*, note 116.

<sup>124</sup> *See Pitofsky, supra* note 6 at 62-63.

<sup>125</sup> *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. ECON. 86 (1960) (r/p/m minimizes free riding).

<sup>126</sup> *Leegin*, 127 S. Ct. at 2716.

market, invariably resulting in higher prices to the consumer for the brand. As discussed above,<sup>127</sup> the Court's answer is that any price increase in the intrabrand market will be tempered by the prices in the interbrand market because at the end of the day, the manufacturer needs to get its goods in the hands of consumers. In other words, the manufacturer in setting the retail price is acting as a surrogate for the consumer. This is manifestly incorrect; a manufacturer's loyalty is divided between retailer and consumer and not always equally. The reality is that the manufacturer's interests are more closely aligned with the retailer.<sup>128</sup> It is the retailer that the manufacturer must please in order to get a pipeline to the consumer. It is the retailer who must receive a margin on its sales sufficient to encourage provision of services to support the manufacturer's products. In short, r/p/m may serve to build good will through generous margins on sales and thus give the retailer significant incentives to promote the product in the interbrand market. In this scenario, the consumer is an afterthought.

### Promotion of Services and Elimination of Free Riding

#### *Enhanced Services*

Use of r/p/m to incentivize dealers to provide ancillary services supporting the manufacturer's product is a risky strategy for manufacturers. Merely providing dealers with higher margins through r/p/m is no guarantee that the desired services will be forthcoming. The dealer may simply pocket the extra dollars and not invest them in brand-related services. Moreover, implementation of r/p/m does not guarantee that the dealer will provide the services that the manufacturer had in mind. Nor is it clear how r/p/m with respect to a specific manufacturer's product would induce a large multiproduct retailer to provide enhanced services store-wide.<sup>129</sup> If the manufacturer wants to be certain

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<sup>127</sup> See *supra* note 119 and accompanying text; see also *Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1161 (7th Cir. 1987) (by fixing the retail price too high a manufacturer would be pricing its [products] out of the market; "consumers would switch to competing products").

<sup>128</sup> See *Hearings, supra* note 116 (statement of Keith I. Clearwater) ("resale price maintenance represents efforts by manufacturers or wholesalers to prevent competition among themselves and in our view is clearly not in the public interest.").

<sup>129</sup> Pitofsky, *supra* note 6 at 63.

that appropriate services will be provided, it could separately contract for those services. That approach is a less restrictive alternative to r/p/m and more likely to moderate any price increase to the consumer by the retailer. In any event, the enhanced services argument is suspect. During the fair trade era, r/p/m agreements were prevalent with respect to consumables that involved no service component.<sup>130</sup>

The Court does not even attempt to analyze the linkage between r/p/m and dealer services. It simply assumes that the price premium that the retailer receives under r/p/m will be used to provide additional services at the point-of-sale. Nor does it discuss impositions of r/p/m where services are clearly not needed, such as in the sale of men's underwear or cologne. In situations where services are desirable, the Court is dismissive of the argument that separately contracting for services is preferable to r/p/m, stating only that it "may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."<sup>131</sup>

### *Free Riding*

Elimination of free riding is perhaps the most frequently invoked rationale for allowing r/p/m.<sup>132</sup> Full-price retailers detest free riders, a/k/a discounters and here is the reason:

A technologically challenged customer goes to the Computer Store in lower Manhattan, a full-line electronics store that carries all major brands of PC, has a trained sales staff and a service department which provides 24/7 support for users. A sales person speaks with the customer, ascertains her needs and demonstrates how various PCs would meet her needs. The sales person may even make a recommendation. After gathering all the information the sales person has to offer, the customer decides to "think things over" and come back the next day. Instead, the customer travels to Hoboken and buys a PC from a no-frills

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<sup>130</sup> *Id.* ("During the period in which state fair trade statutes authorized RPM agreements, minimum resale price maintenance was instituted with respect to cosmetics and over-the-counter pharmaceuticals, along with many other products, including pet food, vitamins, hair shampoo, ammunition, blue jeans and men's underwear. I've yet to see a description of services induced by minimum resale price maintenance with respect to men's underwear or most of the other fair traded products.")

<sup>131</sup> *Leegin*, 127 S. Ct. at 2716.

<sup>132</sup> *Id.* at 2715-16.



discounter at half the price offered by the Computer Store. The Computer Store is outraged because customers extract information from the Computer Store sales person for free and use that information to purchase elsewhere. The discounter got a free ride from the Computer Store. The Computer Store has to charge more for its products than the discounters because it must build into its price the costs of training personnel, services and support.<sup>133</sup>

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<sup>133</sup> See Judge Posner's colorful description of the free riding problem in *Isaksen v. Vermont Castings, Inc.*:

This is a rather sorry excuse for an antitrust case, which may more than anything explain the district judge's action in granting judgment for Vermont Castings. Founded in 1975, Vermont Castings has, as the plaintiff admits, only 10 percent of the midwestern "market" in free-standing woodburning stoves (which are used for heating). We have difficulty understanding how free-standing woodburning stoves could be a meaningful product market, given such excellent substitutes as oil-burning and gas-burning furnaces; and how, even if they do compose a meaningful product market, a product shipped all over the country can be said to be sold in distinct regional markets. But even ignoring these problems, we would have difficulty understanding how a 10 percent factor in a tiny market could restrain competition (viewed as a means of promoting economic efficiency – the contemporary antitrust view, see, e.g., *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 375 (7th Cir. 1986)) merely by placing a floor under its dealers' prices ("resale price maintenance"). If the floor were set higher than necessary to induce dealers to provide the point-of-sale services that would maximize the sale of Vermont Castings' stoves, Vermont Castings not only would be transferring wealth from itself to its dealers (and why would it want to do that?) but would be pricing its stoves out of the market; consumers would switch to competing products whose retail prices were not inflated by resale price maintenance. It is easy to see, however, why, whether or not it possessed any market power, Vermont Castings might want to set the lowest floor under the retail prices of its stoves that would induce its dealers to provide the level of point-of-sale services that maximizes the welfare of consumers. See Telsler, *Why Should Manufacturers Want Fair Trade?*, 3 J. LAW & ECON. 86 (1960). As a new company, selling a somewhat complex product, Vermont Castings needed and still needs dealers who understand the product, can explain it to consumers, and can persuade them to buy it in preference to substitute products made by more established firms. These selling efforts, which benefit consumers as well as the supplier, cost money – money that a dealer can't recoup if another dealer "free rides" on the first dealer's efforts by offering a discount to consumers who have shopped the first dealer. (The second dealer can afford the discount because he doesn't have to incur the selling expenses that were incurred by the first dealer.) As one Vermont Castings' dealer explained in a letter to it, "The worst

Manufacturers, on the other hand, are much more ambivalent about discounters than full-price retailers. Manufacturers like to sell to Wal-Mart and Costco because those stores move product and generate sales volume. At the same time, manufacturers are sensitive to the need to channel products through reputable full-line dealers who have long-term relationships with customers.

The question then is not whether the free-rider phenomenon exists but rather whether r/p/m effectively addresses the free-rider issue. The answer is that r/p/m does not address free-riding or at least does not do so very well. As a threshold matter, free-riding is not the pervasive problem in retailing that the *Leegin* Court suggests. For example, in the clothing industry free-riding is not a problem; it requires little skill for a sales agent to fold clothes or direct customers to the appropriate department in the store.<sup>134</sup> Free riding might be a problem in the electronics/high tech sector, where a service component is desirable; but, in those cases, r/p/m is not a very effective way to encourage dealers to provide services for the reasons just discussed. There is nothing to stop the dealer from simply pocketing the higher levels of profits gained from r/p/m instead of investing in the dealer's brand or establishing maintenance and support services.<sup>135</sup>

In any event, a manufacturer cannot stop free-riding in all its forms. For example, if a department store enjoys a general reputation for good service and its services are not brand-specific, as will typically be the case, r/p/m would not address free-riding. Similarly, r/p/m cannot eliminate free-riding in the form of free delivery by a store.

### Promotion of Entry

In theory, one could argue that r/p/m could encourage new

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disappointment is spending a great deal of time with a customer only to lose him to Applewood [Isaksen] because of price. . . . This letter was precipitated by the loss of 3 sales of V.C. stoves today [to] people who[m] we educated & spent long hours with." A retail price floor prevents such free riding and thus encourages dealers to provide necessary point-of-sale services. And the supplier has every incentive to keep the floor as low as is consistent with assuring adequate services, since he doesn't want to make his product noncompetitive.

825 F.2d 1158, 1161-62 (7th Cir. 1987).

<sup>134</sup> See *Socony-Vacuum Oil Co.*, 310 U.S. at 224 n.59.

<sup>135</sup> See Pitofsky, *supra* note 6 at 63.

entry.<sup>136</sup> A manufacturer of a new product may want to enlist retailers in an effort to get the new product off the ground. Retailers may not be inclined to do so unless they can be assured that their investment in the brand will not be frittered away through later intrabrand price competition. Use of r/p/m may reassure the dealer that its earnings will not erode. In reality, however, r/p/m is simply not necessary to attract dealers. A manufacturer could attract dealers simply by lowering its prices, thus allowing dealers to increase their profit margins without burdening consumers with higher prices.<sup>137</sup>

### Provision of Additional Services

Whether r/p/m encourages retailers to provide services beyond advertising, promotion or repair is pure guess work. This argument suggests that manufacturers are more in tune with the marketplace than retailers and have a better grasp of what will work.<sup>138</sup> It also suggests that the market will push the retailer to furnish the right kinds and quantities of services.<sup>139</sup> These assumptions are questionable at best.<sup>140</sup>

Even if it could be shown as a matter of fact that r/p/m may exert the procompetitive effects discussed above, there is simply no way to determine whether these supposed procompetitive effects outweigh the anticompetitive effects. R/p/m has serious adverse effects on consumers.

First, as already noted, r/p/m invariably results in higher prices to consumers. That, in itself, is at odds with the fundamental rationale for the antitrust laws. Some have argued that r/p/m does not necessarily lead to higher prices because the manufacturer will be constrained in its pricing by competitive conditions in the interbrand market.<sup>141</sup> That argument, premised that a profit-maximizing seller also acts as a surrogate for consumer interests, has a hollow ring.

A principal rationale for r/p/m is the need to provide dealers with both immunization from intrabrand competition and a profit cushion sufficient to encourage dealers to provide services. Clearly, the interests of the manufacturer are more

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<sup>136</sup> See *Leegin*, 127 S. Ct. at 2716.

<sup>137</sup> See Pitofsky, *supra* note 106 at 1494.

<sup>138</sup> See Pitofsky, *supra* note 6 at 63.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> See Pitofsky, *supra* note 106 at 1491.

closely aligned with its dealers than with consumers.<sup>142</sup> Moreover, it is simply not the case that the manufacturer, having made its profit on its sales to a dealer, derives no financial benefit from r/p/m. Where a dealer subject to r/p/m faces stiff interbrand competition, that dealer is likely to seek assistance by asking the manufacturer to cut its prices to the dealer.<sup>143</sup> In that case, the manufacturer may see a reduction in profit margin and thus does have an interest in maintaining the prices that it dictates.<sup>144</sup>

Second, r/p/m is anticompetitive because it limits the consumer choice by "impeding the ordinary give and take of the marketplace."<sup>145</sup> Consumers should be free if they wish to purchase a product from a no frills seller. Nor should consumers be forced to purchase products or services that they either do not want or would prefer to purchase from another source. The Supreme Court in *Topco* described the antitrust laws as the "Magna Carta of free enterprise... as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to protection of our fundamental personal freedoms."<sup>146</sup> The Court in *Topco* further observed that fundamental economic freedom "cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important section of the economy."<sup>147</sup> That admonition applies with equal force to r/p/m. Courts have no way of making this kind of judgment. That reality serves only to underscore the wisdom of the *per se* rule in r/p/m cases.

### *LEEGIN* OFFENDS *STARE DECISIS*

In overruling *Dr. Miles* the Supreme Court failed to give appropriate weight to the doctrine of *stare decisis*. While acknowledging that it was not writing on a blank slate,<sup>148</sup> the Court nevertheless paid lip service to the principle of *stare decisis*. *Stare decisis* is not an inexorable command to affirm on the basis of prior precedent and does not preclude courts from re-

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<sup>142</sup> *Id.* at 1491-92.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> See, e.g., *Indiana Fed'n of Dentists*, 476 U.S. 447.

<sup>146</sup> *Topco*, 405 U.S. at 610.

<sup>147</sup> *Id.*

<sup>148</sup> *Leegin*, 127 S. Ct. at 2720.

examining earlier decisions. Nevertheless, courts do not lightly disregard precedent, especially precedent that is nearly a century old. Rather, they undertake "a series of prudential and pragmatic considerations designed to test the consistency of overruling a prior decision with the ideal of the rule of law, and to gauge the respective costs of reaffirming and overruling a prior case."<sup>149</sup> Courts must ask whether (1) the rule has become intolerable and unworkable; (2) the rule has engendered reliance which would create hardships and inequity were the rule repudiated; (3) the law evolved to a point that renders the rule a remnant of abandoned doctrine; and (4) the facts have changed and have come to be viewed indifferently so as to render the rule unjust.<sup>150</sup>

The answers to these questions fall far short of making the case for overruling *Dr. Miles*. First, *Dr. Miles* had not proven unworkable. It was surely unpopular in the business community but not unworkable. Critics of *Dr. Miles* have pointed to what they perceive as inconsistency in the treatment of vertically imposed price-restraints (illegal *per se*) and vertically imposed territorial restraints (subject to the rule of reason analysis), claiming that in both instances, prices to consumers may well rise.<sup>151</sup> However, simple solutions to complex problems may lead to unjust results. The fact that a rule is difficult to apply does not mean that the rule must be abandoned. *Erie*<sup>152</sup> and its progeny have befuddled proceduralists for years, yet the rule persists because it yields just outcomes. The same is true with regard to the rule of *Dr. Miles*.

Second, reliance cuts in favor of preserving *Dr. Miles*. Congress enacted the Consumer Goods Pricing Act of 1975,<sup>153</sup> repealing the Fair Trade Laws,<sup>154</sup> and thereby reaffirmed *Dr. Miles*. As Justice Breyer noted, "enacting major legislation premised upon the existence of that rule constitutes important public reliance on that rule."<sup>155</sup>

Third, antitrust law has not evolved to the point where the *per se* rule has been abandoned by the courts. To the contrary, the rule of *Dr. Miles* has been repeatedly reaffirmed by the

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<sup>149</sup> *Planned Parenthood of Se. Pa. v. Casey*, 505 U.S. 833, 854-55 (1992).

<sup>150</sup> *Id.*

<sup>151</sup> See Bork, *supra* note 22 at 290 (1978).

<sup>152</sup> *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

<sup>153</sup> Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

<sup>154</sup> McGuire Act, *supra* note 121; Miller-Tydings Fair Trade Act, *supra* note 121.

<sup>155</sup> *Leegin*, 127 S. Ct. at 2732 (Breyer, J. dissenting).

Supreme Court and honored by the lower courts.<sup>156</sup> Indeed, the *Leegin* case itself appears to have been so routine and unremarkable that the Court of Appeals did not even recommend the case for publication in West's Federal Reporter (Third Edition); the report of the case appears in the Federal Appendix.<sup>157</sup>

Fourth, the facts have not changed sufficiently to justify abandoning *Dr. Miles*. The supposed "new insights" into the economic effects of r/p/m are over 30 years old.<sup>158</sup> Indeed, in enacting the Consumer Goods and Pricing Act of 1975,<sup>159</sup> Congress heard and considered the very arguments that the majority in *Leegin* relied on to overrule *Dr. Miles*.<sup>160</sup> Not much has changed in the intervening 30 years, and certainly there has not been sufficient change to justify abandoning a century-old rule.

## R/P/M POST *LEEGIN*

### *The Marketplace*

In the wake of *Leegin*, r/p/m is on the rise.<sup>161</sup> Manufacturers are moving quickly to utilize the new power over price granted by *Leegin*.<sup>162</sup> Retailers are faced with the difficult choice of resisting r/p/m and being cut-off or knuckling under and losing sales volume to bargain-hungry consumers.<sup>163</sup>

### *The Legislature*

Shortly after *Leegin* was decided by the Supreme Court, Senator Kohl convened hearings on the case and later introduced legislation to overrule *Leegin* and codify *Dr. Miles* making minimum r/p/m illegal *per se*.<sup>164</sup> The bill calls the Supreme Court to task for "improperly disregard[ing] 96 years of antitrust law

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<sup>156</sup> See *Khan*, 522 U.S. at 11; *GTE Sylvania*, 433 U.S. at 51.

<sup>157</sup> The Court of Appeals decision in *Leegin* appears at 171 Fed. App'x. 464 (5th Cir. 2006).

<sup>158</sup> *Leegin*, 127 S. Ct. at 2731-32 (Breyer, J. dissenting).

<sup>159</sup> Consumer Goods Pricing Act, *supra* note 153.

<sup>160</sup> *Leegin*, 127 S. Ct. at 2731-32 (Breyer, J. dissenting).

<sup>161</sup> *Pereira*, *supra* note 86.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> The Discount Pricing Consumer Protection Act, S.2261 (2007).

precedent."<sup>165</sup> Hearings were held on July 31, 2007, before the Senate Judiciary Committee, Subcommittee on Antitrust Competition Policy and Consumer Rights, and witnesses testified both for<sup>166</sup> and against.<sup>167</sup>

Query whether this antitrust bill will capture the fancy of Congress in an election year, especially when more fundamental issues involving the Iraq War and a faltering economy loom large in the eyes of the electorate. Legislative restoration of the *per se* rule in r/p/m cases would provide a quick fix but is not necessarily good policy. *Per se* rules are judicially created rules of evidence that are best managed and adapted by the courts. Imposing inflexible standards on the courts limits judicial options and may produce hard results in individual cases, even if rarely. For those reasons, developing the law with respect to r/p/m is best left to the courts.

### *The Courts*

In overruling *Dr. Miles*, the Supreme Court made clear that it was proclaiming a rule of *per se* legality and catalogued circumstances where it viewed r/p/m as a potential threat to competition.<sup>168</sup> The Court also made clear that abandonment of the *per se* rule did not mean simply substituting the unwieldy *Chicago Board of Trade* approach for bright-line rules. Rather, it suggests the following:

As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to insure [that] the rule operates to eliminate anticompetitive restraints

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<sup>165</sup> *Id.* at § 2.

<sup>166</sup> See Pamela Jones Harbour, *A Tale of Two Marks And Other Antitrust Concerns*, 20 LOY. CONSUMER L. REV. 32 (2007); Pamela Jones Harbour, *The Supreme Court's Antitrust Future: New Directions on Revisiting Old Cases?* The Antitrust Source, December 2007, available at <http://www.abanet.org/antitrust/at-source/07/12/Dec07-SupremeSymp12-17.pdf>

<sup>167</sup> *The Leegin Decision: The End of the Consumer Discounts or Good Antitrust Policy?* Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary, 110th Cong. (2007) (statement of Stephen Bolerjack, Dykema Gossett, PLLC) available at [http://www.judiciary.senate.gov/hearings/testimony.cfm?id=2893&wit\\_id=6607](http://www.judiciary.senate.gov/hearings/testimony.cfm?id=2893&wit_id=6607).

<sup>168</sup> *Leegin*, 127 S. Ct. at 2720.

from the market and to provide more guidance to businesses . . . [and] devise rules over time for offering proof, or even presumptions, where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote competitive ones.<sup>169</sup>

The lower court reactions to *Leegin* have been mixed.<sup>170</sup>

With the Supreme Court's counsel in mind, lower courts should consider the following analytical approach for r/p/m cases post-*Leegin*:

- (1) R/p/m is presumptively unlawful.
- (2) Once r/p/m is established, the burden is on the defendant to introduce concrete and persuasive factual evidence showing (a) actual economic benefits to consumers arising from this price-fixing, and (b) that these economic benefits outweigh the anticompetitive effects of price-fixing.
- (3) The economic benefits must be real and tangible and not merely theoretical, presumed or pretextual.
- (4) If the defendant fails to adduce any evidence of procompetitive benefit, then the plaintiff wins.
- (5) If the defendant comes forward with proof of tangible and measurable economic benefits, it bears the further burden of proving that, on balance, the procompetitive effects of r/p/m outweigh its anticompetitive effects.

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<sup>169</sup> *Id.*

<sup>170</sup> Compare *Alaska-Rent-A-Car Inc. v. Cendant Corp.*, 2007 WL 2206784 (D. Alaska Jul. 27, 2007) (dismissing r/p/m claims where prices were competitive with those of some rivals) with *Babyage.com, Inc. v. Toys "R" Us, Inc.*, 523 F. Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss where dominant seller engages in r/p/m); cf. *In re Nine West*, 5 CCH Trade Cases ¶ 16,144 (FTC May 6, 2008) (relieving shoe retailer from obligations under prior Consent Decree involving r/p/m issues).



### *The States*

Because *Leegin* involves the legality of r/p/m under federal law, it does not directly address the issue of vertical price-fixing under state law. *Leegin*, however, will impact r/p/m under state law in those states whose antitrust laws direct the courts therein to follow federal precedent.<sup>171</sup> On the other hand, *Leegin* will have no impact in states like New York<sup>172</sup> and California,<sup>173</sup> where statutes specifically prohibit r/p/m. Failure of businesses to take account of such state laws creates significant legal risks. Thus, while *Leegin* has done much to clarify the federal law relating to vertical price-restraints, many pitfalls for the unwary remain because of variations in state law.<sup>174</sup>

### CONCLUSION

The *Leegin* decision is an ill-considered departure from a century of antitrust precedent. However, it is unlikely that the Supreme Court will revisit the r/p/m issue any time soon. Going forward, the ball is now in the hands of the lower courts to develop workable standards in r/p/m cases. An analytical framework that places burdens on the defendant to prove actual (as opposed to theoretical) competitive benefit and that such competitive benefit outweighs the anticompetitive effects of r/p/m produces a fair and balanced rule.

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<sup>171</sup> See N.Y. GEN. BUS. LAW § 340-47 (1999).

<sup>172</sup> N.Y. GEN. BUS. LAW § 369-a (1975).

<sup>173</sup> CAL. BUS. & PROF. CODE § 16722(d)(e) (West 1997); see *Maitland v. Burckle*, 572 P.2d 1142, 1147 (Cal. 1978).

<sup>174</sup> See generally Jay L. Hines, *New York's Prohibition of Vertical Price-Fixing*, N.Y.L.J., January 29, 2008, at 4 (pointing out that New York law makes vertical price fixing illegal *per se*); M. Russell Wofford and Kristen C. Limarzi, *The Reach of Leegin: Will the States Resuscitate Dr. Miles?* The Antitrust Source, Oct.2007, available at <http://www.abanet.org/antitrust/at-source/07/10/Oct07-Wofford10-18f.pdf>.