Supreme Court Allows Manufacturers to Fix Resale Prices, Subject to Rule of Reason, Overruling *Dr. Miles*

By Aton Arbisser and Saul P. Morgenstern

The Supreme Court swept away nearly a century of precedent that had condemned vertical price fixing as a *per se* violation of the antitrust laws when on June 28, 2007, it held that agreements between suppliers and resellers setting minimum resale prices must be analyzed under the rule of reason. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, No. 06-480, 2007 WL 1835892 (June 28, 2007). The case swings open the door for manufacturers of branded goods or services to impose resale prices on their distributors and retailers, subject to applicable state laws affecting the practice. For reasons explained below, evaluating that option should begin promptly.

The five-justice opinion of the Court, written by Justice Kennedy, overruled *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which had established that such agreements were *per se* unlawful under Sherman Act §1. The majority reiterated that "[r]esort to *per se* rules is confined to restraints 'that would always or almost always tend to restrict competition and decrease output.'" *Id.* at 5, *quoting Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). After reviewing economics literature it found "replete with procompetitive justifications for a manufacturer's use of resale price maintenance" and "studies documenting the competitive effects of resale price maintenance," the Court held that resale price maintenance did not meet the standards for *per se* condemnation because it could stimulate interbrand competition. *Id.* at 6-7. Acknowledging that allowing manufacturers to set resale prices most often will raise the prices of the products involved, the Court nonetheless found that "[r]esale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between." *Id.* at 7. Because such circumstances exist, resale price maintenance cannot be deemed to "always or almost always tend to restrict competition and decrease output" and, therefore, is not, in the Court's modern view, appropriate for *per se* condemnation.

In *Leegin*, a manufacturer of leather accessories terminated a retailer, PSKS, that had been discounting its products. PSKS sued, claiming the termination violated Sherman Act §1. Because Leegin had a program in which retailers pledged to sell at Leegin's suggested prices and Leegin had sought PSKS's agreement to stop discounting before it stopped selling to the store, Leegin recognized that a defense on the basis that its pricing policy had been unilateral, as permitted by *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919), would not likely succeed. At trial, Leegin sought to defend its policy with expert testimony showing the policy's procompetitive effects, but the trial court excluded the testimony as irrelevant on the ground that vertical price fixing was *per se* unlawful. The jury found for PSKS, awarding $1.2 million. After trebling and attorneys' fees, the judgment reached nearly $4 million. The Fifth Circuit affirmed in a *per curiam* opinion. The Supreme Court granted certiorari to determine whether vertical minimum resale price maintenance agreements should be treated as *per se* unlawful.

After reiterating that the *per se* rule is appropriate only "after courts have had considerable experience with the type of restraint at issue," *Id.* at 5, the Court reviewed the basis of the decision in *Dr. Miles,* and determined that its underlying rationales did not justify a *per se* rule. *First*, the *Dr. Miles*' Court held that a vertical pricing agreement was invalid as "a general restraint upon alienation," 220 U.S. at 404-05. The Court has since rejected earlier decisions based upon "'formalistic' legal doctrine rather than 'demonstrable economic effects.'" *Leegin* at

6, *quoting Continental TV, Inc. v. GTE Sylvania Inc.*, 433 U.S.36, 58-59 (1977). *Second*, the *Dr. Miles* Court held that such vertical agreements were analogous to a horizontal combination among competing distributors, which are void. The Supreme Court has since repeatedly rejected efforts to equate horizontal and vertical restraints. *Leegin* at 6, *citing Business Electronics* at 734; *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 348 n.18 (1982).

Freed of *Dr. Miles*, the Court examined the economic effects of vertical minimum resale price agreements. The majority found the economic justifications for vertical price restraints to be similar to those justifying non-price vertical restraints, which are analyzed under the rule of reason and permitted where they stimulate interbrand competition. Several specific rationales were identified: (a) "[a]bsent vertical price restraints, the retail services that enhance interbrand competition might be underprovided"; (b) resale price maintenance can "facilitat[e] market entry for new firms and brands" by inducing the investments needed to promote new products; and (c) resale price maintenance can "encourag[e] retailer services that would not be provided even absent free riding," such as stocking adequate inventories." *Id*. at 7-8.

The majority acknowledged that resale price maintenance carries risks for competition, but adopted the view that those risks could be identified in particular cases rather than assumed to exist in all cases, as the *per se* rule does. The risks included facilitating cartels or exercises of market power at either the manufacturer or retailer level. *Id.* at 8. While the Court recognized that resale price maintenance was likely to (but not invariably) result in higher prices, it opined that such higher prices may sometimes themselves be procompetitive (e.g., making available higher-priced, higher-service products). In the end, the Court relied upon the fact that "in general, the interests of manufacturers and consumers are aligned with respect to [minimizing] retailer profit margins." *Id*. at 9.

The Court discussed the implications of *stare decisis*, ultimately concluding it was not significant in this case because the Court has treated the Sherman Act as a common-law statute where the interpretation "evolve[s] to meet the dynamics of present economic conditions." *Id*. at 11. Thus, *Dr. Miles* became just the latest victim of the systematic rewriting of the antitrust laws in the vertical context, beginning with *GTE Sylvania*, 433 U.S. at 57-59 (abandoning *per se* prohibition on vertical non-price restraints, overruling *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967)) and continuing through *State Oil v. Khan*, 522 U.S. 3, 22 (abandoning *per se* prohibition on vertical maximum price agreements, overruling *Albrecht v. Herald Co.*, 390 U.S. 145 (1968)). The Court also explained that efforts to limit the application of *Dr. Miles* had merely served the interests of lawyers "by creating legal distinctions that operate as traps for the unwary" rather than the interests of consumers. *Id*. at 13.

The *Leegin* decision should have an immediate impact on vertical price fixing claims that have been filed or are being contemplated. It is likely that many such claims will not survive under a rule of reason analysis. And many plaintiffs may choose to abandon their claims rather than invest in the a full-blown rule of reason analysis.

The case has even greater implications for manufacturers' pricing policies. The Supreme Court's decision suggests that resale price maintenance will be subject to "more careful scrutiny" "if many competing manufacturers adopt the practice" or if retailers are the "impetus" for it. *Id*. at 10. As a result, every manufacturer that relies upon others to sell its branded goods or services should *promptly* evaluate whether imposing resale prices on its distributors and retailers would enhance the competitiveness of its product line either by facilitating better resale facilities or by improving the products' image among end user consumers. Implementation of such a program is probably safest when explicitly tied to efforts to enhance interbrand competition.

Before imposing resale prices, manufacturers should review their existing agreements with resellers. To buttress *Colgate* arguments, those agreements may contain provisions that confirm that the reseller may set its own prices or that any prices suggested by the manufacturer are not binding. Those agreements will need to be revised before a manufacturer can adopt a resale price maintenance program.

Adopting such a program is not, of course, risk-free, as the *Leegin* decision does not make such programs *per se* lawful. Manufacturers whose products do not face significant interbrand competition should analyze carefully whether such a program has benefits for the consumers of its products and, ultimately, for it. Similarly, the decision suggests that programs put in place in response to retailer demands for them might support a claim that the program was facilitating a dealer cartel. Resale price maintenance programs in industries where all competitors have similar programs – resulting in a situation where the consumer does not have lower price alternatives – may also invite a challenge as evidence of a horizontal agreement at the manufacturer level. While the evidence at trial may ultimately vindicate the specific program, defending it would be expensive and time consuming. As a result, manufacturers who believe that their business would benefit from such a program would be wise to evaluate it carefully and promptly.

Although the owner of Leegin had interests in retail stores, the Supreme Court left unresolved whether manufacturers with interests at the reseller level would get the benefit of the rule of reason. *Id.* at 14. The Supreme Court has not addressed the dual distribution issue in connection with territorial or customer restraints, but almost every circuit has held that such restraints are to be judged under the rule of reason even where a manufacturer owns some distribution assets, notwithstanding that horizontal restraints on territories or customers are ordinarily *per se* violations. *See, e.g., AT&T Corp. v. JMC Telecom, LLC*, 470 F.3d 525, 531 (3rd 2006).

Finally, the states have their own antitrust laws, and while many of them explicitly follow federal antitrust law, there are exceptions and the law of each state implicated by a minimum resale price agreement should be reviewed.

New York Office
212.836.8000

Chicago Office
312.583.2300

Los Angeles Office
310.788.1000

Washington, DC Office
202.682.3500

West Palm Beach Office
561.802.3230

Frankfurt Office
49.69.25494.0

London Office
44.(0)20.7105.0500

Shanghai Office
86.21.2208.3600