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SUPREME COURT OVERTURNS PER SE RULE AGAINST MINIMUM RESALE PRICE MAINTENANCE

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On June 28, 2007, by a sharply divided 5-4 vote, the Supreme Court overturned the almost 100-year-old rule that vertical agreements—those between firms at different levels of the distribution chain (such as manufacturer and retailer or licensor and licensee)—that set a minimum resale price are illegal per se. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc., d/b/a Kay's Kloset*, No. 06-480, slip op. (June 28, 2007) ("Slip Op."). In overruling its 1911 decision in *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the Court stated that it could not reconcile *Dr. Miles'* per se treatment of resale price maintenance ("RPM") with the Court's "traditional" rule of reason analysis applied in Section 1 cases. Slip Op. at 8. The Court stated that over the course of 30 years it had "progressed away from … [the Dr. Miles] rationale," and that it no longer made sense to analyze vertical non-price restraints and maximum resale agreements under the rule of reason, while continuing to treat RPM agreements as per se unlawful. Slip Op. at 21 (referring to antitrust cases decided in the past 30 years, such as *Continental T.V. Inc. GTE Sylvania Inc.*, 433 U.S. 36. 57-59 (1977) and *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997), which allow non-price vertical restraints and maximum price restraints to be analyzed under the rule of reason respectively).

While the *Leegin* decision represents an important doctrinal development, its practical implications for large firms remain unclear. The Court was careful to note that although resale price maintenance agreements may have (and indeed may usually have) procompetitive effects, RPM will be unlawful when it has anticompetitive effects. In particular, the Court noted that anticompetitive effects are more likely when they involve manufacturers or retailers with market power, or when RPM is commonly used in an industry. Moreover—and of critical importance—RPM may remain unlawful under state law equivalents of Section 1. While federal court decisions interpreting Section 1 are often relevant to state courts' interpretation of state antitrust laws, California and New York, in particular, do not regard federal antitrust precedent as binding. Indeed, almost 40 state attorneys general filed an amicus brief urging the Court not to overrule Dr. Miles, and state antitrust enforcers may now pick up the anti-RPM gauntlet.

A. BACKGROUND

PSKS, Inc. ("PSKS"), a retailer of women's clothing and accessories, brought suit against Leegin, a manufacturer of women's accessories sold under the "Brighton" brand, challenging Leegin's "Brighton Retail Pricing and Promotion Policy." Slip Op. at 2-3. PSKS alleged that Leegin's policy required retailers to follow Leegin's suggested retail price or else risk the suspension of future shipments. *Id*. In December 2002, Leegin discovered that PSKS had discounted its entire line of Brighton products in violation of the pricing policy and stopped shipping Brighton products to PSKS. Slip Op. at 3-4. PSKS sued, claiming that Leegin's pricing policy violated the per se rule against RPM agreements established by *Dr. Miles*. The matter went to trial, and a jury awarded PSKS $3.9 million in damages and attorneys' fees. Slip Op. at 4.

Interestingly, Leegin did not deny the existence of an RPM agreement, having seemingly abandoned its unilateral conduct argument under *Colgate*, *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919). *Id*. Instead, Leegin argued that its agreement requiring retailers to sell at minimum prices should have been analyzed under the rule of reason and that it should have been allowed to submit evidence tending to show the policy's procompetitive benefits. *Id*. The district court had excluded such evidence on the grounds that the per se rule against minimum RPM made such evidence irrelevant. *PSKS, Inc. v. Leegin Creative Leather Prods. Inc.*, 2004 WL 5254322, at *1 (E.D. Tex. Aug. 17, 2004). In response to Leegin's argument that the agreement should have been analyzed under the rule of reason rather than being condemned as illegal per se, the court stated that "whether the per se classification of such agreements is wise is not for this court to decide." *Id.* The Fifth Circuit affirmed the district court's decision, stating that it too "remain[ed] bound to [the Supreme Court's] holding in *Dr. Miles*." *PSKS Inc. v. Leegin Creative Leather Prods.*, 171 Fed. App'x 464, 466 (5th Cir. 2006).

The Supreme Court granted certiorari to decide whether *Dr. Miles'* per se treatment of RPM comports with today's economic learning and with the Court's more modern antitrust decisions, which favor rule of reason analysis over rules of per se illegality. Slip Op. at 1. The federal antitrust agencies weighed in on the issue, urging the Court to overrule *Dr. Miles*. Brief for the United States as Amicus Curiae Supporting Petitioner, No. 06-480, 2007 WL 173650, **1, 3 (Jan. 22, 2007). The agencies maintained that per se treatment was best reserved for agreements where the effects "always, or almost always, reduce[d] consumer welfare[.]" *Id*. at 3. Vertical minimum price agreements, they submitted, did not fall into this category, because RPM agreements could produce either procompetitive or anticompetitive effects. *Id*.

By contrast, the attorneys general of 37 states[1] filed an amicus brief urging the Court to *uphold Dr. Miles*, on the grounds that RPM agreements raised prices and harmed consumers. Citing studies finding that RPM agreements invariably increased prices to consumers, the attorneys general stated that through their attacks on such agreements, they had "recovered more than $115 million in cash and $75 million in product for consumers[.]" States Brief, at 1.

B. THE COURT'S OPINION

The Court rejected arguments in favor of preserving the rule of per se illegality for RPM agreements, concluding that "[i]t cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tends to restrict competition and decrease output.'" Slip Op. at 14 (quoting *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988)). Per se rules, the Court held, were best reserved for restraints that almost invariably restricted competition and reduced output. Slip Op. at 6. Per se treatment was thus inappropriate because, the Court found, contemporary economic literature tended to show that RPM agreements could be used to produce significant procompetitive benefits. Slip Op. at 9-15.

1 The state attorneys general filing the brief were from Alaska, Arkansas, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Utah, Vermont, Washington, West Virginia, and Wyoming.

The Court identified a number of potential procompetitive benefits of RPM:

(1) RPM may increase interbrand competition by encouraging retailers to invest and promote a particular manufacturer's products, thus increasing competition at the manufacturer level. Slip Op. at 10;

(2) RPM may encourage new entry by allowing manufacturers of a new product to incentivize retailers to promote a new or unknown product to consumers. Slip Op. at 11;

(3) RPM may lead retailers to improve their performance if the margins guaranteed by RPM could be revoked should the retailer fail to meet the manufacturer's expectations. Slip Op. at 12.

The Court believed that no reasonable manufacturer would overcompensate retailers with unjustified margins through RPM if that retailer were not providing the enhanced services that resulted in increased customer demand. Slip Op. at 16-17 (noting that manufacturers likely would rely on RPM agreements only "if the increase in demand resulting from enhanced service will more than offset a negating impact on demand of a higher retail price.") (internal quotation marks omitted).

However, the Court also acknowledged that RPM could be used for anticompetitive purposes to harm consumer welfare. First, the Court expressed concern about firms with market power using RPM agreements. Slip Op. at 13-14. The Court stated that manufacturers with market power could use RPM to discourage retailers from selling or promoting competing products by smaller rivals. The Court also noted that retailers with market power could use RPM agreements "to forestall innovation in distribution that decreases costs." *Id.*

Second, the Court acknowledged that RPM could be used to facilitate a horizontal cartel at the manufacturer level by making it easier to detect "cheating" (because prices at the retail level are more transparent than prices at the wholesale level). Slip Op. at 12. RPM could also be used to facilitate a retailer cartel, and therefore, RPM arrangements that are requested by retailers would raise concerns. Slip Op. at 13, 18.

Finally, the Court stated that RPM agreements may be anticompetitive if they are used by a majority of the firms in a market. Under such circumstances, the RPM agreements could "depriv[e] consumers of a meaningful choice between high-service and low-service outlets." Slip Op. at 18 (internal quotion marks omitted).

C. JUSTICE BREYER'S DISSENT

Justice Breyer, joined by three other Justices, dissented from the majority opinion. He stated that he could find no reasonable basis for overturning almost 100 years of settled law. Slip Op. at 11-12. In his view, the economic literature upon which the majority relied "[did] not warrant the Court's now overturning so well-established a legal precedent." Slip Op. at 2.

First, Justice Breyer opined that the majority had dismantled a 100-year-old bright line rule and left a murkier fact-specific rule in its place. Slip Op. at 1. He predicted that lower courts will have difficulty "separat[ing] the beneficial sheep from the antitrust goats." Slip Op. at 8. For example, how feasible will it be, Justice Breyer asked, for a lower court to "identify who—producer or dealer—is the moving force behind any given resale price maintenance agreement." Slip Op. at 9. He suggested that making such factual distinctions would not be very easy. Slip Op. at 9.

Second, Justice Breyer accused the majority of having failed to consider the cost involved in litigating RPM agreements under the rule of reason—especially in light of the fact that the benefits of such agreements are so speculative. Slip Op. at 22 (stating that "we cannot conclude with confidence that the gains from eliminating the *per se* rule will outweigh the costs"); see *also id.* at 10 (noting that "litigating a rule of reason case is one of the most costly procedures in antitrust practice") (internal quotation marks omitted). Third, Justice Breyer criticized the majority's disregard for *stare decisis* when multiple factors exist favoring the maintenance of the status quo. Slip Op. at 17-21.

D. IMPLICATIONS

1. Federal Antitrust Claims

Leegin represents an important step in the evolution of the treatment of vertical agreements under federal antitrust law. Henceforth (with the exception of tying arrangements involving a product with market power), there are no vertical agreements that remain subject to per se condemnation. (The Court refused to overturn the per se rule against tying in *Jefferson Parish Hosp. District No. 2 v. Hyde*, 466 U.S. 2, 17 (1984). Although per se treatment of tying makes little if any doctrinal sense after *Leegin*, lower courts are likely to continue to follow that precedent until the Supreme Court formally overrules it.)

Nevertheless, a manufacturer, wholesaler, or intellectual property licensor will continue to face significant risks if it requires its customers/licensees to charge minimum prices, even after *Leegin*. It is important to recognize that rule of reason treatment in the minimum RPM context will be a far cry from the virtual *de facto* rule of per se *legality* that has applied to *maximum* RPM since the Supreme Court overturned the per se rule against maximum RPM in *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997).

Under the burden-shifting regime that is often used in rule of reason cases, the plaintiff bears the initial burden of proving the agreement is likely to harm competition (which usually requires, as a threshold matter, proof that the defendant has market power). If the defendant produces a procompetitive justification for its actions, the plaintiff must show that the adverse effects of the conduct outweigh the procompetitive benefits. Where, for example, a manufacturer claims that an agreement setting a minimum price is necessary to ensure that retailers provide adequate service, they will need to be prepared to respond to arguments that this goal could have been achieved through other means, or that the services provided are outweighed by the increase in prices to consumers. Given that manufacturers have been addressing retailer service concerns for nearly a hundred years without the ability to use minimum RPM, this may be a significant hurdle.

The Court's decision also leaves firms exposed to risks not faced in the typical rule of reason case. Lack of market power is usually a defense to a rule of reason claim, but the Court's decision makes clear that antitrust liability may attach when a manufacturer lacks market power—for example, where RPM facilitates a retailer cartel. Imposing RPM at the request of a retailer thus presents significant risks. In addition, the Court expressed concerns about RPM when its use is widespread in an industry, resulting in denying consumers a choice between high price/high service and low price/low service goods. Nothing in the *Leegin* decision suggests that this will only be an issue for firms with market power.

Finally, the court left open the treatment of minimum RPM in the dual distribution context—where the manufacturer both sells to and competes with its retailers—because the issue was not properly presented on appeal. While most appellate decisions treat restraints imposed by a dual distributor under the rule of reason, they have never had to grapple with minimum RPM, which could be characterized as horizontal price fixing in the dual distribution context. Thus, minimum RPM by a dual distributor could be viewed by some lower courts as still subject to per se treatment.

2. Risks Under State Law

The *Leegin* decision addresses only the treatment of minimum RPM under federal antitrust law. Almost all states also have their own state antitrust laws, which to date most have treated minimum RPM as illegal per se. As the state attorneys general noted in their amicus brief, the states have been particularly active in RPM enforcement.

While many states have followed decisions interpreting federal antitrust law either as a matter of statute or judicial decision, in states such as California and New York, federal antitrust decisions are not controlling. *See State ex rel. Van de Kampe v. Texaco, Inc.*, 762 P.2d 385, 395 (Cal. 1998) (stating that "judicial interpretation of the Sherman Act, while often helpful, is not directly probative of the Cartwright drafters' intent"); *Anheuser-Busch, Inc. v. Abrams* 71 N.Y.2d 327, 335, (N.Y. 1988) ("Although we do not move in lockstep with the Federal courts in our interpretation of antitrust law, the Donnelly Act—often called a 'Little Sherman Act'—should generally be construed in light of Federal precedent and given a different interpretation only where State policy, differences in the statutory language or the legislative history justify such a result.") (internal citation omitted). For example, state courts' willingness to deviate from federal court interpretations of federal antitrust law can be seen in their rejection of the Supreme Court's holding in *Illinois Brick*. *See*, e.g., *Hyde v. Abbott Labs. Inc*., 473 S.E.2d 680, 684-85 (N.C. Ct. App) (interpreting state counterpart of Sherman Act to authorize indirect purchaser suits), *review denied*, 478 S.E.2d 5 (N.C. 1996); *McLaughlin v. Abbott Labs*., No. CV 95-0628 (Ariz. Super. Ct. Yavapai Co. July 9, 1996) (same); *Blake v. Abbott Labs*., 1996-1 Trade Cas. (CCH) ¶ 71,369 (Tenn. Ct. App. Mar. 27, 1996) (same); *Mack v. Bristol-Myers Squibb Co.*, 673 So.2d 100, 103 (Fla. Dist. Ct. App. 1996) (interpreting state deceptive practices act to authorize indirect purchaser suits) Firms, therefore, would be well-advised to move cautiously with revision of their RPM policies, especially in light of the state antitrust risk.

E. CONCLUSION

While the rule of per se illegality for RPM agreements is now gone, it is likely that RPM agreements will remain risky in many situations— including where used by firms with large market shares. As a matter of prudent antitrust counseling, *Leegin* should not be viewed as equivalent to *Khan* (which, as a practical matter, eliminated much of the risk involved in maximum resale price maintenance agreements), or of *GTE Sylvania* (which has given manufacturers significant freedom to implement vertical non-price restraints). While no longer subject to automatic condemnation as illegal per se conduct, many RPM agreements may have sufficient adverse effects on competition to be found unlawful under the rule of reason.

If you would like more information about the Leegin decision, please contact your Arnold & Porter attorney or:

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