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LEGAL DEVELOPMENTS

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SUPREME COURT OVERTURNS CENTURY-OLD PRECEDENT; ALLOWS RULE OF REASON TREATMENT FOR MINIMUM RESALE-PRICE-MAINTENANCE AGREEMENTS

In 1911, the Supreme Court held in *Dr. Miles* that agreements between manufactures and distributors to set minimum resale prices are illegal *per se*. Last week, in *Leegin*, the Court overturned *Dr. Miles*, holding that such agreements should be reviewed under the rule of reason. The decision allows manufacturers to establish, under certain circumstances, 'floor' pricing to their retailers.

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Background

In 1911, the Supreme Court established the *per se* illegality of agreements to set minimum Resale Price Maintenance (RPM). Since then, courts have read *Dr. Miles* as establishing a bright-line, *per se* illegality rule for minimum RPM agreements.

In 1968, the Court established a similar rule for *maximum* RPM agreements. The Court overruled that decision in 1997, holding that such agreements should be evaluated under the rule of reason, which allows a defendant to demonstrate that the alleged restrictive conduct is not an unreasonable restraint of trade.

The Supreme Court had emphasized on several occasions that the rule of reason is "the accepted standard for testing whether a practice restraints trade in violation [of the antitrust laws]." Accordingly, the Court refused to extend *per se* treatment to other vertical restraints – restraints that, like RPM, involve different levels of the distribution chain (such as manufactures and distributors). Indeed, the time *Leegin* was heard by the Supreme Court, minimum RPM was the only remaining *per se* vertical restraint.

The Facts of *Leegin*

Leegin manufactured Brighton leather goods and accessories. PSKS operates a woman's apparel store in Texas under the name Kay's Kloset, which sold the Brighton brand. In 1997, Leegin instituted a Retail Pricing Policy, announcing it would refuse to sell to any retailer that will discount Brighton goods below the suggested prices. In 2002, Leegin discovered that Kay's Kloset discounted Brighton's entire line by 20 percent. After a short negotiation, Leegin stopped selling to the store. PSKS then sued on behalf of Kay Kloset, arguing that Leegin violated the antitrust laws by setting a minimum RPM. Both the district and appellate courts sided with PSKS, ruling, based on *Dr. Miles*, that Leegin's conduct was illegal *per se*. The Supreme Court agreed to hear the case.

The Court's Analysis of Minimum RPM

Writing for the Court, Justice Kennedy (joined by Chief Justice Roberts and Justices Scalia, Thomas, and Alito) began his analysis by noting that the *per se* rule should be confined to restraints such as agreements among competitors to fix prices or divide markets that experience demonstrates "always or almost always tend to restrict competition or decrease output."

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Because minimum RMP does not always or almost always restrict competition, the Court argued, it should not be subject to the *per* se rule, and, instead should be subjected to the rule of reason. Indeed, the Court argued, while minimum RPM may reduce intrabrand competition (i.e., competition between retailers of the same brand), it generally stimulates interbrand competition (i.e., competition between brands). As the Court noted, this distinction is important because protecting interbrand competition is "the primary purpose of the antitrust laws."

With extensive citation to the economics literature, the Court argued that minimum RPM stimulates interbrand competition in a number of ways. First, it eliminates the "free rider" problem. This problem occurs when a customer learns about a product by visiting a full-service (and full-price) retailer who has invested in services such as a fine showrooms, product demonstration, and knowledgeable staff, and then turns to a discount retailer to complete the purchase. In such a case, the discounter "free rides" off the full-service retailer's investment, which reduces that retailer's incentive to offer such services in the first place. Second, and closely related, minimum RPM facilitates entry of new brands and products because retailers would be more inclined to carry new merchandize if they can be assured that their investment in the new brand will be recouped.

To be sure, the Court noted that minimum RPM agreements may also have anticompetitive effects. For example, a group of competing manufacturers who had agreed to fix prices might use minimum RPM agreements to monitor discounting manufacturers. Alternatively, a group of competing retailers could agree to fix prices and then force a manufacturer to institute a minimum RPM policy to prevent other retailers from discounting. Further, a dominant manufacturer could use minimum RPM policy to prevent retailers from selling the products of smaller rivals or new entrants. Alternatively, a dominant retailer might force a manufacturer to institute a minimum RPM policy to prevent other distributors from gaining market share. Therefore, the Court warned, even after accepting the rule of reason analysis for minimum RPM, "courts would have to be diligent in eliminating their anticompetitive uses from the market."

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Practical Implications:

1. According to Federal law, manufactures are no longer entirely barred from setting 'floor' prices to their distributors. This does not mean, however, that they are *per se* lawful.
2. To determine whether a minimum RPM agreement is lawful, the following factors will be relevant: (i) whether the policy was suggested by the manufacturer or the retailer, with harm to competition more likely if the policy was initiated by a retailer; (ii) whether the manufacturer or retailer implementing the policy has market power, with harm to competition more likely if market power is present; and (iii) whether minimum RPM policies are prevalent in the relevant market, with harm to competition more likely the more competing manufacturers have adopted similar policies.
3. State laws still vary on the subject. While most States will probably follow *Leegin,* some may insist on holding minimum RPM as illegal *per se.*

Due to the nature of the analysis announced by the Court, a careful review by antitrust counsel *prior* to setting RPM agreements is highly recommended.

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