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Living with *Leegin*: The Demise of *Dr. Miles* and the *Per Se* Rule Against Minimum Resale Price Maintenance

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Overruling a nearly 100 year-old precedent, in a 5-4 decision, the Supreme Court has ruled that agreements setting minimum retail prices and other minimum resale prices no longer are *per se* illegal under the US federal antitrust laws, and instead, must be "judged by the rule of reason" on a case-by-case basis. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 550 U.S. __ (decided June 28, 2007), *overruling Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

The facts were simple. Leegin, a maker of leather goods and accessories, asked retailers to agree to charge specified resale prices. When PSKS refused to stop discounting, Leegin terminated the relationship. A jury awarded nearly $4 million and on appeal the manufacturer did not dispute that it had entered into resale price maintenance agreements with its retailers. The Fifth Circuit affirmed on the authority of *Dr. Miles*, and the Supreme Court granted certiorari to reconsider the *per se* rule.

In an opinion written by Justice Kennedy, joined by the Chief Justice and Justices Scalia, Thomas, and Alito, the Court noted that there are three principal justifications for resale price maintenance: (1) combating the "free riding" that discourages dealers from providing services that consumers want (and, presumably, that manufacturers want); (2) facilitating entry by new brands; and (3) encouraging even dealers not threatened by free riding to provide more services, by overcoming the difficulty and inefficiency of requiring such services through contract. The Court criticized the reasoning of *Dr. Miles*, observing that it was based, by way of a 1628 treatise, on the common law rule against restraints on alienation, and that the decision erroneously analogized vertical restraints to horizontal agreements among dealers. The Court also rejected the argument that *Dr. Miles* should be retained on the ground of *stare decisis*, responding that: (1) the Sherman Act is akin to the common law and equally dynamic; (2) *Dr. Miles* already has been limited by subsequent cases; (3) *Dr. Miles* was inconsistent with cases (particularly *United States v. Colgate & Co.*, 250 U.S. 300 (1919)) permitting manufacturers to achieve the same end through different but less efficient means; and (4) non-price vertical restraints, such as territorial restraints, have a similar impact to resale price maintenance but have been subject to a different standard.

The most crucial part of the opinion for many is what the Court had to say about how the rule of reason should be applied to resale price maintenance agreements in the future. The Court pointed out that resale price maintenance may, in fact, have anticompetitive effects when it is "designed solely to obtain monopoly profits" by "facilitat[ing] a manufacturer cartel" or "organiz[ing] cartels at the retailer [or other dealer] level." The Court held: "A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful." This is not surprising, and simply reconfirms earlier decisions on horizontal agreements among manufacturers or dealers to fix prices or divide customers. (Note that the Court cites *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332 (1982), more than once, suggesting that the current *per se* rule against horizontal *maximum* price fixing announced there remains unshaken, at least for the time being. Also note that when the Court provided examples of *per se* violations that still exist, it named only "agreements among competitors to fix prices … or to divide markets" and skipped any type of tying.)

The Court went on to explain that even in the absence of horizontal agreements, resale price maintenance can still be unlawful, though not *per se* unlawful, when induced by a dominant retailer trying to frustrate innovation by smaller retailers, or when adopted by a dominant manufacturer trying

to persuade dealers not to carry competing brands from smaller rivals or new entrants.

In other words, horizontal use of resale price maintenance remains *per se* unlawful; use by a dominant dealer or manufacturer will be subject to the rule of reason.

And what is the "recipe" for conducting a rule of reason assessment of a resale price maintenance agreement? The Court pointed out that resale price maintenance "does have economic dangers" and noted that lower courts will have to be "diligent in eliminating their anticompetitive uses from the market." It went on to explain that such diligence is a "realistic objective" so long as courts recognize three factors that are "relevant to the inquiry," specifically: (1) the number of manufacturers in a market adopting resale price maintenance, with "more scrutiny" required "if many competing manufacturers" adopt the practice; (2) the "source" of the restraint, i.e., the manufacturer or the dealers, with an independent decision by the manufacturer being less suspect; and (3) market power, as less powerful retailers cannot prevent manufacturers from distributing their products through other retailers, and less powerful manufacturers cannot "keep competitors away from distribution outlets."

The Court added that as lower courts "gain experience" they can establish a "litigation structure" and "devise rules over time" for offering proof, "or even presumptions where justified," to make application of the rule of reason "fair and efficient." Only time will tell which rules and presumptions might emerge, but it is clear that the key factors will be: (1) how "dominant" the retailer and manufacturer are (i.e., how much market power they each possess); (2) whether the manufacturer or the dealer is the real source of the restraint; and (3) how widely resale price maintenance is adopted among the brands competing in the relevant market.

The dissent, written by Justice Breyer and joined by Justices Stevens, Souter, and Ginsburg, described the application of the rule of reason to resale price maintenance as the onset of a period of "legal turbulence." The dissent remarked that under the rule of reason it may not be very easy "to separate the beneficial sheep from the antitrust goats," because it is often difficult to identify who actually instigated a vertical restraint – the manufacturer or the dealers – and because the majority's "invitation" to evaluate market power will invite battles of experts, applying "abstract, highly technical, criteria to often ill-defined markets." Note that the dissent expressed concern over "tacit collusion" among manufacturers, not just outright conspiracy, while the majority limited its concern with manufacturer collusion to hardcore manufacturers' cartels. The dissent also went on to summarize statistics suggesting that retailing has become more concentrated in America and so has manufacturing, citing as examples makers of various household appliances. In the end, the dissent conceded that if the Court were writing on a clean slate, the *per se* rule might properly be modified, particularly to accommodate an exception for new entrants, but concluded that the case had not been made for overturning a nearly 100 year-old precedent.

So, what can we expect now? Before long, we may begin to see nationwide advertising featuring uniform prices for some products at retailers across the country. But before entering into agreements to fix resale prices, there are some critical questions you must confront:

- Will your new agreements pass muster under a reasonableness test? The Supreme Court did not rule that resale price maintenance is *per se* **legal**, only that it is no longer *per se* **illegal**. Will your new resale price agreement meet the Court's new criteria?

- What other restraints do you already impose on your dealers? May dealers carry competing brands, or have they agreed to carry your brand exclusively? The existence of exclusive dealing on top of resale price maintenance may impact the analysis.

- How many competing brands will also elect to use resale price maintenance agreements? How many will not? How significant are these competing brands? If resale price maintenance becomes widespread in your market, how will this affect the reasonableness of your agreements?

- Is there any hint of horizontality among dealers? If dealers get together to agree on resale prices, such a "horizontal" agreement will still be *per se* illegal; and if a manufacturer or other supplier participates in that agreement, that party can face liability, too.

- Worse yet, is there any hint of horizontality among manufacturers? If manufacturers or other suppliers reach an understanding on the resale prices each will set, this will be treated as horizontal, cartel-type price fixing, with criminal consequences possible.

- What about private label brands? If a manufacturer sells a branded product to retailers and also produces a retailer's private label variety of the product, may the manufacturer agree with the retailer on the resale price of either brand? Both brands? Would such agreements be "vertical" or "horizontal"?

- Do your present contracts permit the introduction of resale price maintenance agreements? Do your present contracts instead specify that each dealer is free to set its own resale prices? (Such provisions became popular in years past as a defense against allegations of resale price maintenance.)

- Are you subject to state franchising or distributor laws, and if so, do those laws permit the introduction of resale price maintenance?

- Do the antitrust laws and other competition laws of the states in which your products are resold permit enforcement of resale price maintenance agreements? Not all necessarily do.

- Will your agreements apply to resale in other countries, including sales through the Internet? If so, do the laws of those countries permit resale price maintenance?

- If a manufacturer or other supplier controls the resale prices at which its dealers resell, will it become responsible, under the so-called "indirect purchaser" doctrine, for any price discrimination engaged in by those dealers that might violate the Robinson-Patman Act or state price discrimination laws? If so, how can a supplier minimize its exposure?

- How will dealers react? What will happen if dealers enter into resale price maintenance agreements and then violate them? Do all dealers need to be treated the same?

- How will competitors react? Will brands choosing not to introduce resale price maintenance agreements be neglected by dealers or will they gain an advantage, at least at some dealers?

- How will consumers react? Research suggests that the human brain is wired to love a bargain – can resale price maintenance backfire?

The answers will not be the same for all companies or all products.

Yet these questions need to be answered for each individual situation, and an approach needs to be tailored for each seller and each product before launching into minimum resale price agreements.

Bottom Line: The Supreme Court has ushered in a lively new era of distribution in America, but this is not a "one size fits all" world. Master it, and you can make the most of it.

If you have any questions about these developments, please feel free to contact Richard Steuer, +1.212.506.2530, rsteuer@mayerbrownrowe.com.