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The Doctor Is Out, But Is Resale Price Maintenance In?

Key Questions for Clients Considering Resale Price Maintenance (RPM) after *Leegin*

1. **Why do you want to adopt RPM?** A strong business rationale to promote interbrand competition will be critical to overcome any legal challenge to the program.

2. **Is the impetus for RPM coming from your retailers?** Group pressure for RPM emanating from your retailer network can be used as evidence that the restraint is facilitating a retailer cartel, or supporting a less efficient, but dominant, retailer.

3. **Do others in your industry have resale price maintenance policies?** If the manufacturers employing RPM do not account for a dominant share of the market, a court will be less likely to conclude that the practice could facilitate a manufacturer cartel.

4. **What is your market share?** Low market share makes it less likely that a manufacturer's RPM agreements could even potentially achieve the kinds of anticompetitive effects described in *Leegin*.

5. **How does *Leegin* affect the law in the states where you want to sell?** Not all state antitrust laws follow the federal law. RPM may continue to be illegal *per se* in some states, and state attorneys general may continue their enforcement efforts in this area.

Supreme Court Overturns 96-Year-Old-Precedent

On June 28, 2007, in a landmark 5-4 decision, the Supreme Court fundamentally changed the law governing antitrust claims based on alleged resale price maintenance ("RPM") agreements. The Court said goodbye to one of its longstanding antitrust precedents, *Dr. Miles Medical Co. v. John D. Park & Sons Co*,[1] when it ruled that resale price maintenance would no longer be *per se* illegal. *Leegin Creative Leather Products v. PSKS, Inc.*, No. 06-480, __ S.Ct. __, 2007 WL 1835892 (June 28, 2007).

Leegin (pronounced like "legion") involved an antitrust challenge to Leegin's policy of refusing to sell its specialty leather goods and accessories to retailers who discounted below suggested prices and its related marketing program, which required participating retailers to pledge to sell at the suggested prices. The trial court precluded the defendant from introducing expert testimony regarding the pro-competitive effects of its policies because RPM agreements were *per se* unlawful under *Dr. Miles*. After losing at trial, the defendant challenged the application of the *per se* rule to its conduct. Bound by *Dr. Miles*, the Fifth Circuit affirmed.

The Supreme Court granted *certiorari* to reconsider the question it decided long ago in *Dr. Miles*, namely "whether vertical minimum resale price maintenance agreements should continue to be treated as *per se* unlawful." In an opinion by Justice Kennedy, the Court

[1] 220 U.S. 373 (1911).

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decided to jettison the *per se* rule. The decision rested on several key points:

- *Dr. Miles* represented a departure from the accepted rule-of-reason standard for evaluating restraints generally, and for evaluating vertical restraints specifically, under the Sherman Act.
- The underpinnings of *Dr. Miles* had been eroded by subsequent decisions recognizing the "differences in economic effect between vertical and horizontal agreements, differences the *Dr. Miles* Court failed to consider" because it relied on "'formalistic' legal doctrine rather than 'demonstrable economic effect.'"
- The abundant economic literature recognizing pro-competitive justifications for a manufacturer's use of resale price maintenance argued against a *per se* approach, which is reserved for situations in which the practice always or almost always restricts competition and decreases output.
- A manufacturer in a competitive market will generally have no incentive to overcompensate its retailers with inflated margins, since to do so would not increase the manufacturer's margin, but would reduce the sale of its products.
- Applying a *per se* rule to vertical price fixing and the rule of reason to other vertical restraints created an anomalous situation which drove manufacturers to less efficient distribution methods and created legal distinctions that became "a trap for the unwary."

Rule-of-Reason Guideposts

Possible pro-competitive justifications: Manufacturers considering a resale price maintenance program after *Leegin* must still make sure it will withstand scrutiny under the rule of reason. This will require a sound pro-competitive justification. The majority opinion offered several possibilities. These included:

- encouraging retailers to invest in providing additional services for consumers by offering the retailer a "guaranteed" margin;
- giving consumers more options, allowing them to "choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between;"
- facilitating market entry for new firms and brands; and
- minimizing the risk of "free-riding"—situations in which discounting retailers "capture some of the demand" generated by other retailers who invest in increased services, thereby reducing the incentive to do so.

Potential anti-competitive effects: While shutting the door on *Dr. Miles*, the Court also clarified the specific types of *interbrand* anti-competitive effects that might support a rule-of-reason violation. The Court noted that an RPM agreement might be used to facilitate a horizontal manufacturer or retailer cartel, forestall innovation in distribution that decreases costs, or exclude rival manufacturers. Relevant factors to consider in determining whether or not such an anti-competitive use of RPM is plausible include, among others:

- the number of competing manufacturers that have adopted RPM agreements;
- whether the impetus for the RPM agreement was the manufacturer or its dealers; and
- whether the participating manufacturers and retailers possess market power in a properly defined relevant market.

The Court observed that anti-competitive uses of RPM are unlikely in situations in which the participating retailers or manufacturers lack market power, or in which only a few manufacturers in a relevant antitrust market use RPM.

Implications for Manufacturers

Manufacturers with free rider issues: The manufacturers with the most immediate interest in *Leegin* are likely to be those who currently employ programs to prevent free riding. These may either take the form of vertical territorial or customer restrictions or a program seeking to take advantage of the *Colgate* doc-

trine permitting manufacturers to terminate discounting dealers unilaterally.[2] These manufacturers may now want to consider whether some form of RPM is a more efficient way to solve their free-rider issues.

E-tailers: Although the Court did not discuss internet retailing, *Leegin* may give manufacturers the poison-dipped arrow with which to shoot down widespread discounting of their products (and resulting eviscera-tion of their brand equity) over the internet. One of the commonly asserted justifications for resale price maintenance in such circumstances is to prevent free riding. Even Justice Breyer, writing for the dissent, acknowledged the avoidance of free riding as one of the important consumer benefits of resale price maintenance. Under a rule-of-reason analysis, this may prove a powerful argument to justify imposing RPM requirements on internet sellers.

Intellectual property owners: Of potential interest will be the degree to which *Leegin* carries over into the intellectual property arena. In 1926, in *United States v. General Electric Co.*,[3] the Supreme Court held that a patent owner could agree with its licensee on a minimum price which the licensee must charge for articles manufactured under the license. Subsequent decisions have undermined this precedent but never overruled it,[4] and most intellectual property owners have therefore been reluctant to incorporate pricing restrictions of any kind in their licenses. *Leegin* opens the door to a reconsideration of many of the decisions that have undermined *GE* as a reliable precedent.

Impact on State Antitrust Law and Enforcement – A Caution

The *Leegin* decision eliminated the *per se* rule for RPM as a matter of *federal* antitrust law only. While the large majority of *state* antitrust laws require adherence to federal antitrust precedents, some state laws do not. In states that do not look to federal law, RPM may be (or could become) *per se* illegal.

Enforcement attitudes may differ as well. Cases against RPM have been a significant enforcement priority of state attorneys general over the last 25 years. So, whereas the federal antitrust agencies argued as *amicus* in *Leegin* that *Dr. Miles* should be overruled, an *amicus* brief submitted by a large number of state attorneys general argued just the opposite—that *Dr. Miles* should not be overruled and that RPM should continue to be governed by the *per se* rule.

This suggests that state attorneys general might continue to police this area, either by exploiting the lines of attack suggested by the Court or under state laws that do not require adherence to federal precedent. Their ability to do so could be bolstered if state legislatures amend their antitrust laws to reinstate the *per se* rule for RPM within the state. Such a legislative response would not be unprecedented. A majority of the states, for example, passed legislation in the 1980s to exempt their state antitrust laws from the Supreme Court's *Illinois Brick*[5] decision denying federal standing to indirect purchasers. Nor would such legislation necessarily be pre-empted by federal law.[6]

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2 *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

3 272 U.S. 476(1926).

4 *See*, e.g., *United States v. Line Material Co.*, 333 U.S. 287, 293-97 (1948) (*General Electric* not applied to cross-licensed patents); *United States v. Univis Lens*, 316 U.S. 241, 249-51 (1942) (*General Electric* does not apply after the first sale of a product by the licensor); *Newbourgh Moire Co. v. Superior Moire Co.*, 237 F.2d 283 (3d Cir. 1956) (*General Electric* does not apply to multiple licenses containing price-fixing provisions); *Cummer-Graham Co. v. Straight Side Basket Corp.*, 142 F.2d 646 (5th Cir. 1944) (*General Electric* does not apply to restrictions on the price of an unpatented good manufactured using a patented process).

5 *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

6 *See*, e.g., *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978).

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/antitrust.

Jeffrey W. Brennan
Washington, D.C.
+1 202 261 3326
jeffrey.brennan@dechert.com

Stephen D. Brown
Philadelphia
+1 215 994 2240
stephen.brown@dechert.com

Peter R. Crockford
London
+44 20 7775 7506
peter.crockford@dechert.com

Paul T. Denis
Washington, D.C.
+1 202 261 3430
paul.denis@dechert.com

Rebecca P. Dick
Washington, D.C.
+1 202 261 3432
rebecca.dick@dechert.com

H. Joseph Escher III
San Francisco
+1 415 262 4545
h.joseph.escher@dechert.com

Michael D. Farber
Washington, D.C.
+1 202 261 3438
michael.farber@dechert.com

Carolyn H. Feeney
Philadelphia
+1 215 994 2247
carolyn.feeney@dechert.com

James A. Fishkin
Washington, D.C.
+1 202 261 3421
james.fishkin@dechert.com

Paul H. Friedman
Washington, D.C.
+1 202 261 3398
paul.friedman@dechert.com

George G. Gordon
Philadelphia
+1 215 994 2382
george.gordon@dechert.com

Robert C. Heim
Philadelphia
+1 215 994 2570
robert.heim@dechert.com

Kevin T. Kerns
Philadelphia
+1 215 994 2729
kevin.kerns@dechert.com

Edward L. Kling
London
+44 20 7184 7612
edward.kling@dechert.com

Christine C. Levin
Philadelphia
+1 215 994 2421
christine.levin@dechert.com

Pierre-Manuel Louis
Brussels
+32 2 535 5479
pierre.louis@dechert.com

Isabelle M. Rahman
Brussels
+32 2 535 5445
isabelle.rahman@dechert.com

Stephen A. Stack, Jr.
Philadelphia
+1 215 994 2660
stephen.stack@dechert.com

Robin P. Sumner
Philadelphia
+1 215 994 2425
robin.sumner@dechert.com

Joseph A. Tate
Philadelphia
+1 215 994 2350
joseph.tate@dechert.com

Chris Watson
London
+44 20 7184 7610
chris.watson@dechert.com

Dechert LLP
www.dechert.com

U.S.

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