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Supreme Court Overrules Century-Old Precedent: Resale Price Maintenance to be Judged Under the Rule of Reason

On June 28th, the Supreme Court issued its opinion in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, S. Ct. No. 06-480. The single question for decision was “whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason.” The Court, in a 5-4 decision, overruled *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 US 373 (1911), and held that “vertical price restraints are to be judged by the rule of reason.” Justice Kennedy wrote the majority opinion, in which Chief Judge Roberts, and Justices Scalia, Thomas and Alito joined. Justice Breyer filed a dissenting opinion in which Justices Stevens, Souter and Ginsburg joined.

The Court’s decision applies to practices that are effectively vertical price restraints. It encompasses traditional resale price maintenance (“RPM”), where a seller controls its products’ resale price. It applies to situations in which a franchisor specifies a franchisee’s retail prices even if the franchisor does not provide the products that are resold. It also applies to prohibitions on price advertising a manufacturer or franchisor imposes on those lower in the distribution chain. For example, pre-*Leegin*, a manufacturer could condition the availability of cooperative advertising money on the retailer’s use of the manufacturer’s suggested price in the advertisement, but the manufacturer could not – without running afoul of the per se rule – preclude the retailer from using its own money to advertise prices it chose independently. Now, an agreement prohibiting advertising any price other than the one set by the manufacturer will be evaluated under the rule of reason.

The Court relied on the unremarkable premise that rule of reason analysis is the norm, and that the per se rule of illegality the exception; as the Court put it, “departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing.” It concluded that *Dr. Miles* depended formalistic line drawing, in that it was rooted in common-law rules about restraints on alienation, rather than on economic effects, and also because it failed to give proper weight to the difference between vertical agreements on the one hand and horizontal agreements on the other.

The Court then considered the likely competitive effects of vertical resale price maintenance. It noted that the economics literature is “replete” with procompetitive justifications for RPM, and the chance that RPM might in some circumstances have anticompetitive effects did not justify the application of the per se rule. Even if RPM increased retail prices, it might still benefit interbrand competition – the focus of the antitrust laws – by eliminating free riding, increasing the quality and amount of services provided at retail, and facilitating new entry by firms and brands. Anticompetitive harm – such as facilitating cartels at the dealer or manufacturer level or the abuse of market power by a dominant firm – can still be addressed under the rule of reason. The majority best summed up its underlying view of the merits when it wrote that applying the per se rule to RPM “is a flawed antitrust doctrine that serves the interests of lawyers – by creating legal distinctions that operate as traps for the unwary – more than the interests of consumers – by requiring manufacturers to choose second-best options to achieve sound business objectives.”

Justice Breyer’s strong dissent gave a nod to the majority’s view by acknowledging that were the court ruling on a clean slate, the question would be difficult, largely because there RPM can be procompetitive or anticompetitive. But, he argued in dissent, the absence of hard data on how often the procompetitive benefits are achieved, combined with courts’ general unsuitability for identifying the “instances in which the benefits are likely to outweigh potential harms,” weighed in favor of maintaining the per se rule (perhaps with some minor tweaks), even if ruling on a clean slate.

At first glance, bringing resale price maintenance under the rule of reason is a clear win for manufacturers, franchisors, and others that want to control downstream prices. After all, the conventional wisdom is that rule of reason is “code” for “defendants win.” There are several reasons, however, to believe that rule of reason treatment may create litigation and liability risks for manufacturers using Unilateral Price Policies (“UPPs”) or adopting RPM policies. First, many courts were not comfortable with applying the per se rule to RPM, and so they tried to avoid finding that the manufacturer and dealer had “agreed” on the price to be charged; cases were dismissed early. If the business arrangement is to be judged on its competitive merits, the courts might be more likely to allow cases that they would have dismissed before to go to the jury. Likewise, some UPPs may be found to have crossed the “unilateral” line in application, thus requiring an analysis of competitive effects.

Rule of reason treatment also carries liability risk because RPM often results in increased transaction prices. Once past the “agreement” threshold, a complaint alleging a price increase and the absence of any procompetitive benefits may well be sufficient to survive a motion to dismiss. A seller will then need to demonstrate that the price increase is not anti-competitive, because the RPM policy also had procompetitive benefits that outweigh the price increase. Quantifying those benefits is likely to be difficult and contentious, and, particularly in the case of a dominant seller that could have market power, the issue may not be amenable to resolution on summary judgment: trial may be required.

A third reason comes from the serious discussion in both the majority and dissenting opinions of the use of RPM to facilitate horizontal collusion at the retailer/dealer or manufacturer level. Widespread use of RPM in concentrated industries is likely to be a fertile ground for class action litigation. Indeed, when the FTC challenged the use of RPM-like minimum advertised price programs by all sellers in a concentrated industry in *In re Sony*, subsequent private litigation ensued.

Finally, federal rule of reason treatment raises the possibility of conflicts with various states’ antitrust law, under which RPM may continue, at least for some period of time, to be treated as per se unlawful. It also raises problems in cross-border transactions; for example, RPM is still per se illegal in Canada.

In conclusion, application of the rule of reason does give manufacturers, franchisors and those similarly situated more leeway to adopt RPM policies and to incorporate them into distribution agreements (as opposed to the UPP approach) without inevitably inviting treble damage litigation and liability. It is not, however, a free pass. Manufacturers and franchisors should evaluate their existing UPPs and be prepared to defend adopting new RPM programs by documenting the existence of a procompetitive rationale for the practice and any measurable procompetitive benefits. They should also be sensitive to the underlying dynamics of their industry lest they unintentionally facilitate dealer collusion.

Without the bright line of the per se rule, manufacturers and franchisors will have more freedom to control their downstream pricing, but more responsibility for the results as well. It would indeed be ironic if in abandoning the per se rule – which the Court called “a flawed antitrust doctrine that serves the interests of lawyers – by creating legal distinctions that operate as traps for the unwary” – the Court created yet more uncertainty and fueled an increase in antitrust litigation.

If you have any questions regarding the foregoing, please feel free to contact one of the attorneys listed below.

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