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The Lessons of *Leegin*: Supreme Court Overturns 96-Year-Old Ban on Resale Price Maintenance

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On June 28, 2007, in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, __ S. Ct. __ (2007) (slip op.), http://www.supremecourtus.gov/opinions/06pdf/06-480.pdf, the Supreme Court overruled nearly 100 years of precedent and held that resale price maintenance (RPM) agreements are not *per se* violations of Section 1 of the Sherman Act and must be evaluated under the rule of reason. *Leegin* is a landmark decision that brings new opportunities—as well as possible pitfalls—for companies in structuring their distribution arrangements.

The *Leegin* Decision

RPMs are agreements between a manufacturer and a retailer under which the retailer agrees not to price below a specified level. The Court held in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), that RPM agreements were *per se* illegal under the Sherman Act. Accordingly, for the past century, courts deemed all such agreements illegal—whether or not they actually lessened competition in the relevant market. This all changed with *Leegin*.

Leegin arose from a leather goods manufacturer's decision to cut off sales to a retailer that had been cutting prices in violation of an alleged RPM agreement. The retailer prevailed on its Sherman Act Section 1 claim after the trial court, applying *Dr. Miles*, prohibited the manufacturer from introducing expert testimony describing the pro-competitive benefits of the alleged RPM agreement. The Fifth Circuit affirmed.

The Supreme Court reversed and explicitly overruled *Dr. Miles*. Justice Kennedy, writing for the five-Justice majority, first explained that, in its recent jurisprudence, the Court has applied the *per se* rule only when an agreement "would always or almost always tend to restrict competition and decrease output." Slip. op. at 6. In cases involving other types of vertical restraints, the Court had already rejected the fundamental policy and economic rationale for the *Dr. Miles per se* rule. *Id.* at 7-9. Reviewing recent economic literature, the Court found that, though RPM agreements may harm competition in some circumstances (e.g., by facilitating cartels), they often enhance competition by giving retailers incentives to promote the manufacturers' products, facilitating entry by new competitors and otherwise stimulating competition among rival suppliers of branded products. *Id.* at 9-12. The Court then held that because RPM agreements may have either pro or anticompetitive effects depending on the circumstances, they should be evaluated under the rule of reason, not prohibited *per se*. *Id.* at 14-15. The Court went on to reject arguments that *Dr. Miles* should remain the law because the rule of reason would be too difficult to administer (*id.* at 15) or based on principles of *stare decisis*. *Id.* at 19-28.

The Court held that RPM agreements, like other vertical restraints, must be evaluated on a case-by-case basis under the rule of reason, balancing any anticompetitive effects from the restraint against procompetitive benefits. *Id.* at 14-15. Importantly, the Court provided some guidance to lower courts about three factors that may be particularly relevant in applying the rule of reason to RPM agreements. *Id.* at 17-18. These include:

- *The number of competitors in the market that have adopted RPM agreements*. The possibility that RPM agreements are facilitating cartels is less likely when few competitors employ such agreements, but "[r]esale price maintenance should be subject to more careful scrutiny . . . if many competing manufacturers adopt the practice."
- *Whether the RPM originated with the manufacturer or the retailer*. The Court observed that because a manufacturer generally has incentives to promote efficient distribution that are aligned with the interests of consumers, harm to competition is more likely if RPM agreements are brought about as a result of retailer pressure rather than on the manufacturer's own initiative.
- *Whether the manufacturer or retailer party to the RPM agreement has market power*. "If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers . . . [a]nd if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets."

The Court viewed these factors as a starting point for the lower courts to develop substantive standards and procedural rules for evaluating RPM agreements under the rule of reason. In particular, the Court wrote that lower courts should "establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses" by, for example "devis[ing] rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones." Slip op. at 19.

Implications of *Leegin*

In light of *Leegin*, businesses have new opportunities under the federal antitrust laws to structure distribution arrangements with RPM agreements. Many companies will want to explore whether certain distribution practices that may have been implemented to avoid running afoul of the *Dr. Miles per se* rule can be restructured to accomplish distribution goals more effectively and efficiently. For example, companies that currently use exclusive distribution arrangements or operate minimum advertised price programs may want to consider whether to implement RPM agreements in addition to or in lieu of these practices. Similarly, companies that operate so-called "*Colgate*" policies, where manufacturers unilaterally announce resale prices and terminate retailers that do not comply but do not reach price agreements with retailers, may want to consider restructuring their arrangements to incorporate actual RPM agreements.

It is critical, however, to recognize that *Leegin* does not immunize businesses from challenges to RPM agreements. In considering whether to implement RPM agreements, it is essential that companies work with counsel to structure RPM arrangements to minimize the antitrust risks. In some circumstances, well-advised companies may determine that the benefits of RPM agreements still do not justify the legal risks.

Among the issues that companies should consider when contemplating RPM agreements are these:

- RPM agreements are **not** *per se* legal. Courts will apply the rule of reason, likely paying particular attention to the three factors that the Supreme Court set forth in *Leegin* as well as others. Companies will want to consider carefully how the proposed RPM arrangements are likely to fare under the factors the Court discussed, especially when the arrangement involves a party that may have market power at either the manufacturing or retail level.
- Lower courts may also construe the Court's opinion to authorize structured, "quick look" analysis and engage in less searching inquiry to uphold or condemn RPM arrangements than a full rule of reason analysis would involve. Although courts have rarely condemned vertical non-price restraints under the rule of reason, given the historical political, legal, and economic controversy surrounding RPM arrangements, courts may be more likely to condemn RPM arrangements than other types of vertical restraints.
- Many states have their own (sometimes idiosyncratic) antitrust or unfair competition statutes, which state courts or enforcers may interpret to prohibit RPM agreements *per se*. Many states follow federal antitrust precedent in interpreting their own statutes, but it is possible that state courts may decline to follow *Leegin*. It is also possible that state legislatures could pass legislation specifically prohibiting RPM agreements, similar to the "*Illinois Brick* repealer" statutes that many states enacted when the Supreme Court held that indirect purchasers lack standing to bring federal antitrust claims.
- Most foreign jurisdictions (including Canada and the European Union) view RPM agreements as hardcore(and sometimes criminal) violations of their competition laws. Accordingly, companies that institute RPM agreements will need to consider carefully whether the agreements could affect commerce outside the United States and result in legal exposure there.
- Horizontal price fixing and market division remain *per se* illegal. Accordingly, if RPM

agreements are used as a mechanism to enforce cartels at the manufacturer or retailer level, that the parties characterize the arrangement as RPM will not save them from severe civil and possibly criminal penalties.

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In *Leegin*, the Supreme Court overturned a venerable but often criticized antitrust precedent, and announced that RPM agreements will be evaluated under standards that assess their actual competitive effects rather than under bright line rules. Although this groundbreaking development presents many opportunities, businesses should be careful to evaluate and minimize antitrust risk under federal, state, and foreign law.

For more information on this or any other antitrust and competition matters, please contact the authors listed above.

Authors

Leon B. Greenfield

PARTNER

leon.greenfield@wilmerhale.com

+1 202 663 6972