Statement of

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Before the

HOUSE JUDICIARY COMMITTEE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Regarding

"BYE BYE BARGAIN? RETAIL PRICE FIXING, THE *LEEGIN* DECISION, AND ITS IMPACT ON CONSUMER PRICES"

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Chairman Conyers, Ranking Member Smith, and members of the Subcommittee, I am Richard Brunell, Director of Legal Advocacy for the American Antitrust Institute ("AAI"). Thank you for this opportunity to present the views of the AAI as you consider Congress's response to the Supreme Court's *Leegin*[1] decision which, by a vote of 5-4, overturned the venerable *Dr. Miles*[2] case and the *per se* rule against resale price maintenance ("RPM"), which Congress had long endorsed. AAI is an independent non-profit research, education, and advocacy organization that supports the strong and sensible enforcement of our antitrust laws to ensure that markets are competitive for the benefit of consumers and the economy as a whole.[3] We believe that consumer welfare and economic innovation are best served when retailers are free to engage in discounting, and therefore urge this committee to take action to restore some version of the *per se* rule.[4]

Executive Summary

What have we learned in the almost two years since the *Leegin* decision? It appears that, as expected, the use of resale price maintenance programs has increased, even though antitrust counselors have advised caution because some state attorneys general have taken the position that RPM remains *per se* illegal under some state laws and other states have passed or may pass

[1] Leegin Creative Leather Products, Inc. v. PSKS, Inc. 127 S. Ct. 2705 (2007).

[2] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

[3] Background is available at www.antitrustinstitute.org. AAI's views on a wide range of competition policy issues are set forth in THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT. This book has been provided to Subcommittee members and is available on our website.

[4] AAI has been actively involved in the debate over RPM. We filed an *amicus* brief in *Leegin* urging the Court not to overturn *Dr. Miles*, submitted comments in the FTC's *Nine West* matter opposing Nine West's petition to lift resale price restrictions, provided written testimony to the Senate Judiciary Committee in support of Senator Kohl's Discount Pricing Consumer Protection Act, and testified before the Maryland legislature in support of legislation reaffirming the *per se* rule under Maryland antitrust law. All of these submissions are available on AAI's website. Many of the points discussed here are elaborated in Richard M. Brunell, *Overruling* Dr. Miles: *The Supreme Trade Commission in action*, 52 ANTITRUST BULL. 475 (2007).

"*Leegin* repealer" bills. Anecdotally, we also believe there has been greater use of "*Colgate* policies" and minimum advertised pricing (MAP) polices to enforce minimum resale prices. Allowing manufacturers to forestall discounting is problematic at any time, but it is particularly unfortunate during this time of deep recession when consumers depend on discounts to make ends meet and manufacturers may be more pressured than ever to use RPM to forestall price wars.

We have also learned that, as expected, the so-called "rule of reason" adopted by the Supreme Court for judging RPM agreements amounts to a rule of virtual *per se legality*. The Court said that RPM agreements were to be evaluated on a case-by-case basis, and courts would have to be diligent in eliminating anticompetitive uses from the market, but in most of the cases decided after *Leegin*, the lower courts summarily dismissed the complaints because the relevant markets alleged by plaintiffs were said to be too narrow as a matter of law; plaintiffs were not even allowed to try to prove their cases. The problem with using an unstructured rule of reason for RPM is not simply that it ordinarily requires proof of a relevant market and that the defendant has market power, which is difficult and expensive to establish even if one gets past a motion to dismiss. The problem is that the Supreme Court fundamentally misunderstood the nature of the competitive harm from RPM.

The Court and its Chicago-School supporters look at the higher prices that result from RPM and say, "so what." We should assume that the manufacturers' and consumers' interests are congruent; the manufacturer would prefer its retailers to sell at the lowest prices possible in order to increase sales. If the manufacturer adopts RPM it must therefore be because it will somehow increase the demand for its product notwithstanding the higher prices, perhaps because the RPM will induce retailers to offer services that make the product more attractive to consumers. Higher prices are only anticompetitive, the argument goes, when they are result of collusion

among manufacturers or retailers, or perhaps the result of a dominant, inefficient retailer pressuring the manufacturer to adopt RPM.

The critics of RPM, notably including Congress when it repealed the fair trade laws in 1975, look at the higher prices and see harm to consumers. When a manufacturer announces that it will not permit prices to fall below a certain level, they are suspicious. They know that manufacturers are not so fond of retail discounting because it can put downward pressure on wholesale prices, and that a fixed retail price on one product can put a floor under the price of competing products that are not even subject to RPM. So when they see the higher prices that result from RPM they say, "show me the consumer benefit." Yet, the business justifications generally offered for RPM provide no real benefit to consumers.

The most common justification is that RPM allows a manufacturer to buy better distribution or shelf space from retailers that carry competing brands, but while this may increase the manufacturer's sales, it does not benefit consumers; on the contrary, it may give retailers an incentive to push the product with the larger margin protected by RPM even when it may be inferior to competing products. Another common justification is that RPM can prevent no-frills retailers from "free riding" on full-service retailers, but even when this is a plausible concern, RPM is a poor mechanism for addressing it. And finally, RPM is often touted as a tool to maintain the brand image of high-end products, which seems to be more about deceiving consumers than benefitting them. In any event, even if these objectives were thought to be legitimate, there are less restrictive ways for manufacturers to achieve them, such as paying retailers directly for services. The problem with RPM is that, regardless of the purpose for which it is used, it tends to prevent more efficient retailers, who have expert local knowledge of the needs and shopping behavior of their customers, from passing on the benefits of their lower costs to consumers. This centralization of decision-making not only harms consumers in the short run, it slows down in-

novation and productivity in the retailing sector by impairing an important tool for innovative retailers to gain market share.

Introduction

This testimony is organized as follows: First, I will explain why the issue of the *per se* rule is important as a practical matter and requires action by Congress. Second, I will explain why *Leegin* was wrong as a matter of both jurisprudence and policy, including the following:

- The Court flouted the intent of Congress favoring the *per se* rule and thereby usurped Congress's authority to make national competition policy in an area in which Congress has been intensely involved.

- The Court underplayed the magnitude of the anticompetitive risks of RPM, including higher prices and reduced efficiency and innovation in retailing, and failed to recognize that those risks have increased with increasing retail concentration.

- The Court overplayed the possible procompetitive uses of RPM and failed to acknowledge that there is no empirical evidence that such uses are common or important.

- The Court failed to consider that any procompetitive effects of RPM can be achieved by less restrictive alternatives that do not prevent efficient retailers passing on their lower costs to consumers.

- The Court erroneously believed that there were no good justifications for treating RPM and nonprice vertical restraints differently.

- The Court failed to recognize the costs of the rule of reason, including an increased incidence of anticompetitive RPM, increased business uncertainty and litigation expenses.

The Practical Importance of the *Per Se* Rule

AAI believes that the *Leegin* decision was wrong as a matter of jurisprudence and policy for many of the same reasons articulated by Justice Breyer in his powerful dissent on behalf of four Justices.[5] As Justice Breyer explained:

[5] AAI is not alone. The academic criticism of *Leegin* has been substantial. *See, e.g.,* Edward D. Cavanagh, *Vertical Price Restraints After* Leegin, 21 LOY. CONSUMER L. REV. 1 (2008); Warren S. Grimes, *The Path Forward After* Leegin: *Seeking Consensus Reform of the Antitrust Law of Vertical Restraints,* 75 ANTITRUST L. J. 467 (2008); Lance McMillian, *The Proper Role of Courts: The Mistakes of*

> The *per se* rule forbidding minimum resale price maintenance agreements has long been "embedded" in the law of antitrust. It involves price, the economy's "'central nervous system.'" [citation omitted]. It reflects a basic antitrust assumption (that consumers often prefer lower prices to more service). It embodies a basic antitrust objective (providing consumers with a free choice about such matters). And it creates an easily administered and enforceable bright line, "Do not agree about price," that businesses as well as lawyers have long understood.[6]

But before exploring in detail the reasons that *Leegin* was wrongly decided, let me explain why the issue is important as a practical matter and offer four reasons why Congress needs to act now to repeal *Leegin*.

First, two years have passed since *Leegin* was decided, and we can observe the early returns: not unexpectedly, numerous press reports indicate that the ruling has resulted in increased use of resale price maintenance agreements[7] and "soft" RPM programs such as "*Colgate* policies" and minimum advertised price (MAP) policies.[8] Under a *Colgate* or "unilateral" minimum price policy, a manufacturer obtains compliance with minimum retail prices, not by explicit agreement, but by threatening to cut off noncompliant dealers. Under a MAP policy, a manufacturer prevents retailers from advertising below a minimum price. Manufacturers have favored these "soft" RPM programs because many states, including California and New York, may con-

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the Supreme Court in Leegin, 2008 WISC. L. REV. 405; Mark D. Bauer, *Whither Dr. Miles*?, 20 LOY. CONSUMER L. REV. 1 (2007).

[6] 127 S. Ct. at 2736.

[7] *See, e.g.,* Joseph Pereira, *Price Fixing Makes Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1 (stating that "[m]anufacturers are embracing broad new legal powers that amount to a type of price fixing" and offering several examples); Joseph Pereira, *Why Some Toys Don't Get Discounted – Manufacturers Set Minimums That Retailers Must Follow Or Risk Getting Cut Off,* WALL ST. J., Dec. 24, 2008, at D1 (in the wake of *Leegin* "many manufacturers have instituted pricing minimums for advertising or sales"); Saul Hansell, *For Sony, No Discounts Means Stress Free Shopping*, NewYorkTimes.com, Bits Blog, Nov. 20, 2008, http://bits.blogs.nytimes.com/ 2008/11/20/stressed-sony-says-high-prices-will-help-you-relax/? (describing Sony "Unified Resale Execution," introduced in June, which bans retailers from discounting certain high-end products).

[8] *See* Joseph Pereira & John R. Wilke, *Instruments, Audio Gear Scrutinized in Price Probe*, WALL ST. J., Oct. 23, 2008, at B1 (noting that manufacturers "have grown more interested in establishing minimum advertised prices since the ruling"); Joseph Pereira, *Discounters, Monitors Face Battle on Minimum Pricing*, WALL ST. J., Dec. 4, 2008, at A1 (describing growth of firms that monitor pricing on the web as a result of proliferation of MAP policies).

tinue to treat RPM agreements as *per se* illegal under state antitrust laws;[9] accordingly, antitrust counselors have advised caution in adopting express RPM agreements, at least on a national basis.[10] While *Colgate* policies have always been lawful in theory, prior to *Leegin* manufacturers were often inhibited from adopting such policies because implementing a *Colgate* program was perceived by many to be draconian, costly, and impractical; it required a manufacturer to terminate otherwise-valued noncompliant retailers and to refrain from price discussions with any retailers.[11] After *Leegin*, however, antitrust lawyers have been advising manufacturers that *Colgate* policies may be more flexible because the consequences of running afoul of the *Colgate* limitations are not as severe.[12] Similarly, prior to *Leegin,* MAP policies were typically limited to

[9] *See* Michael A. Lindsay, *Resale Price Maintenance and the World After* Leegin, 22 Antitrust, Fall 2007, at 32.

[10] *See* M. Russell Wofford, Jr. & Kristen C. Limarzi, *The Reach of* Leegin: *Will the States Resuscitate* Dr. Miles?, ANTITRUST SOURCE, October 2007, at 1, http://www.abanet.org/antitrust/at-source/07/10/Oct07-Wofford10-18f.pdf ("[T]houghtful commentators have noted that the continuing uncertainty about the states' treatment of minimum resale price maintenance could slow the business response to *Leegin*.").

[11] *See* Brian R. Henry & Eugene F. Zelek, Jr., *Establishing and Maintaining an Effective Minimum Resale Price Policy: A* Colgate *How-To,* ANTITRUST, Summer 2003, at 8, 8 ("Under *Colgate*, the cautious supplier has but one choice with respect to violators – immediate termination of product purchasing privileges with no warnings, no second chances, and no continued shipments in response to assurances of future compliance – regardless of the size of the violator and the volume of its purchases."). Ironically, the Court cited the cost of implementing a *Colgate* policy as a justification for adopting the rule of reason. *See Leegin*, 127 S. Ct. at 2722-23. In addition to restoring some version of the *per se* rule, Congress should also limit the use of the *Colgate* doctrine as a means of avoiding strictures against RPM, as discussed below.

[12] *See* Lindsay, *supra*, at 36 (noting that "now is the time to reconsider" adopting a *Colgate* policy because "*Leegin* has reduced the exposure that would result if a unilateral policy inadvertently becomes (or is perceived as becoming) an 'agreement.'"); Marie L. Fiala & Scott A. Westrich, Leegin Creative Leather Products: *What Does the New Rule of Reason Standard Mean for Resale Price Maintenance Claims?*, ANTITRUST SOURCE, Aug. 2007, at 9, http://www.abanet.org/antitrust/at-source/07/08/Aug07-Westrich8-6f.pdf (explaining that having a *Colgate* policy is "now less risky than it was in the past"); Thomas B. Leary & Erica S. Mintzer, *The Future of Resale Price Maintenance, Now That* Doctor Miles *is Dead*, 4 N.Y.U. J. L. & BUS. 303, 341 (2007) ("[M]anufacturers with *Colgate* programs[] may be able to discuss their differences with non-compliant retailers, rather than terminating them absolutely as they heretofore have been required to do.").

manufacturer-financed (co-op) advertising and allowed significant "leakage" in discounting.[13] After *Leegin*, so-called "bald" MAP policies (i.e., those that apply regardless of whether the manufacturer pays for the advertising) that leave less room for discounting are less risky.[14]

Second, the fact that many states *may* continue to treat RPM as *per se* illegal does not undercut the need for Congress to restore the *per se* rule under the Sherman Act. Commentators have generally concluded that it is unclear how courts will interpret existing state statutes, even if attorneys general favor a *per se* rule. Most state antitrust statutes are construed in harmony with federal law. Only one state – Maryland – has amended its statute in light of *Leegin* to expressly adopt the *per se* rule.[15] And some have suggested that state laws that adopt a *per se* rule might be preempted by the Sherman Act.[16] In any event, a state-by-state approach will offer no protection to consumers in states that follow federal law and, perhaps most significantly, will not permit the federal enforcers to bring RPM cases on a *per se* basis.

Third, while it is true that *Leegin* did not make RPM *per se* legal, and the Court offered that "courts would have to be diligent in eliminating their anticompetitive uses from the market" under the rule of reason,[17] the way that the courts have interpreted *Leegin* so far suggests that the rule of reason will devolve into a rule of virtual *per se* legality, as it has with nonprice vertical restraints. Several lower courts (including the lower court on remand in *Leegin*) have dismissed

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[13] Indeed, where minimum advertised pricing policies are tantamount to RPM because discounting is effectively precluded, the FTC had said it would consider them to be *per se* illegal. *See* In re Sony Music Entertainment, Inc., No. C-3971, 2000 WL 1257799 (F.T.C.).

[14] *See* Lindsay, *supra*, at 36. *But see* New York v. Herman Miller, Inc., 08-CV 2977 (S.D.N.Y. 2008) (complaint by Attorneys General of New York, Michigan and Illinois challenging "bald" MAP policy as resale price maintenance agreement under state and federal law where the advertised price was the price at which a consumer purchased the product).

[15] *See* 2009 Md. Laws c. 44 (approved by the governor April 14, 2009), *available at* http://mlis.state.md.us/2009rs/chapters_noln/Ch_44_hb0657T.pdf.

[16] *See, e.g.,* Lindsay, *supra*, at 33.

[17] *Leegin*, 127 S. Ct. at 2719.

RPM complaints on motions to dismiss for failing sufficiently to allege a relevant market, not even permitting plaintiffs to *try* to prove a rule of reason violation, even though the cases involved allegations of market power and dual distribution (i.e., manufacturers that sell at retail, in competition with their dealers, as well at wholesale).[18] Indeed, even the FTC interpreted *Leegin* to permit RPM in a case where the leading manufacturer of women's fashion shoes (albeit with "only a modest market share") engaged in dual distribution, RPM practices appeared to be widespread in the industry, and its purported procompetitive efficiencies were "unproven."[19]

Fourth, Congress should not wait to act for the completion of the FTC's workshops on RPM. While the FTC (Commisioner Harbour in particular) is to be commended for undertaking to study RPM, it is not clear when or what the end product of the workshops will be. As discussed below, empirical studies in the past have been inconclusive. And insofar as the FTC offers policy prescriptions or guidelines for courts, such recommendations will be constrained by the *Leegin* decision.

To be sure, *Leegin* is not going to mean the end of consumer discounts, even if RPM is effectively legalized by the courts. Manufacturers often like retail discounting, and discount chains are a well-established, significant part of retailing. As the Court noted, even in the fair trade era when resale price maintenance was generally legal, only a small fraction of goods was fair traded. However, as Justice Breyer countered, that small fraction would translate into sig-

[18] *See* PSKS, Inc. v. Leegin Creative Leather Products, Inc., 2009 WL 938561 (E.D. Tex. 2009); Spahr v. Legin Creative Leather Products, Inc., 2008 WL 3914461 (E.D. Tenn. 2008) (consumer class action); Jacobs v. Tempur-pedic Int., Inc., 2007 WL 4373980 (N.D. Ga. 2007) (consumer class action). *But see* Babyage.com v. Toys "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss).

[19] *In re Nine West Group Inc.*, FTC Dkt. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008) ("FTC *Nine West* Order").

nificant dollar amounts in today's retail marketplace of more than $3 trillion.[20] Moreover, increasing retail concentration and buyer power suggest that the risk of anticompetitive, retailer-induced RPM has increased significantly since the fair trade era. And during this time of deep recession, it is particularly important that consumers not be forced to pay higher unnecessarily high prices, even as manufacturers may be more tempted than ever to use RPM to forestall price wars.

***Leegin* is Bad Jurisprudence**

Thirty-four years ago, the Subcommittee on Monopolies and Commercial Law held hearings on H.R. 2384, the bill that was enacted as the Consumer Goods Pricing Act of 1975.[21] The law repealed the so-called "fair trade" amendments to the Sherman Act – the Miller-Tydings Act of 1937 and the McGuire Act of 1952 – which had authorized states to legalize resale price maintenance agreements.[22] The Subcommittee, headed by Representative Peter Rodino, heard testimony from numerous witnesses, including the Deputy Assistant Attorney General, Keith Clearwaters, and the Chairman of the Federal Trade Commission, Lewis Engman, both of whom testified in favor of restoring the *per s*e rule of *Dr. Miles*.[23] The Senate Judiciary Committee also held seven days of hearings with 23 witnesses, including the Assistant Attorney General for Antitrust, Thomas Kauper, who testified to the same effect.[24] The Committee reports show that Congress believed that RPM was pernicious and should be banned. The Committees heard the

[20] Justice Breyer estimated that if prices on goods subject to resale price maintenance rose by the same rate that occurred in the fair trade era, retail bills would increase by an average of roughly $750 to $1000 for a family of four. 127 S. Ct. at 2736.

[21] Pub. L. No. 94-175, 89 Stat. 801 (1975).

[22] The Miller-Tydings Act is the only substantive amendment to Section 1 of the Sherman Act in its entire history.

[23] *See Fair Trade: Hearings on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 94th Cong. 3, 109 (1975) [*House Hearings*].

[24] *See Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the S. Comm. on the Judiciary*, 94th Cong. 176-77 (1975).

arguments, similar to those made today, that resale price maintenance could be procompetitive in some circumstances, yet rejected any exceptions to the *per se* rule.[25]

Congress passed the Consumer Goods Pricing Act with overwhelming, bipartisan support, and President Ford enthusiastically signed it into law.[26] In 1977, when the Supreme Court in *GTE Sylvania* adopted the rule of reason for nonprice vertical restraints, it expressly stated that different treatment of resale price maintenance was justified in part because Congress had approved the *per se* rule.[27] After the Reagan Administration's Justice Department sought to overturn the *per se* rule in *Monsanto*,[28] Congress passed appropriations measures in 1983, 1985, 1986, and 1987 preventing the Department from using appropriated funds for this purpose.[29] Such measures were no longer needed when the (first) Bush Administration came to office and promised to enforce *Dr. Miles*.[30] Between 1990 and 2000, the FTC and Department of Justice brought about 14 RPM cases; the States also brought numerous cases.[31]

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[25] For a review of this history, see Brunell, *supra*, at 487-88.

[26] Statement by President Gerald R. Ford Upon Signing the Consumer Goods Pricing Act of 1975 (law "will make it illegal for manufacturers to fix the prices of consumer products sold by retailers").

[27] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977) ("Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair-trade pricing at the option of the individual States" but "[n]o similar expression of congressional intent exists for nonprice restrictions.").

[28] Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984). The Court declined to reach the issue. *See id.* at 760 n. 7; *see also id*. at 769 (Brennan, J., concurring).

[29] *See* H.R. Rep. No. 237, 102d Cong., 1st Sess. 4 (1991) ("With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as the area of resale price maintenance ('RPM')."

[30] *See* Speech by Ass't Attorney General James F. Rill, 57 Antitrust & Trade Reg. Rep. (BNA) 671, Nov. 9, 1989 (stating that the Antitrust Division would not advocate change to the *per se* rule and would "not hesitate to bring a resale price maintenance case, contingent only on evidence sufficient to establish a genuine resale price conspiracy and facts showing a significant regional impact"); *see also Interview With Former Assistant Attorney General James F. Rill*, 63 Antitrust & Trade Reg. Rep. (BNA) 254 (Aug. 27, 1992) (favoring "a *per se* illegality principle applied to resale price maintenance").

[31] *See* Brunell, *supra,* at 479 & n.22 (listing cases).

There matters stood until the Roberts Court granted certiorari in *Leegin* to reconsider the *Dr. Miles* rule, notwithstanding that there was no great hue and cry demanding that *Dr. Miles* be reversed. On the contrary, the bipartisan Antitrust Modernization Commission had declined to study the topic, noting that there was "a relatively low level of controversy on the subject."[32]

What did the Court have to say about the legislative history showing Congress's endorsement of the *per se* rule? The Court responded:

> The text of the Consumer Goods Pricing Act did not codify the rule of *per se* illegality for vertical price restraints. It rescinded statutory provisions that made them *per se* legal. Congress once again placed these restraints within the ambit of § 1 of the Sherman Act. And, as has been discussed, Congress intended § 1 to give courts the ability "to develop governing principles of law" in the common-law tradition. [citations omitted] Congress could have set the *Dr. Miles* rule in stone, but it chose a more flexible option. *We respect its decision* by analyzing vertical price restraints, like all restraints, in conformance with traditional § 1 principles, including the principle that our antitrust doctrines "evolve with new circumstances and new wisdom." [citations omitted][33]

With all due respect, we believe, like the dissenters,[34] that by ignoring the obvious purpose of the Consumer Goods Pricing Act to extend the *per se* rule, the Court failed to respect Congress's will. Indeed, the Court's "common law" approach to the Sherman Act – unconstrained by congressional intent and its own precedent – reflects an ominous trend in judicial lawmaking. The Court has set itself up as the principal antitrust policymaker for the country, a "Supreme Trade Commission," except that unlike the Federal Trade Commission, it is staffed with law clerks rather than antitrust experts, has no ability independently to gather data, and is not subject to agency oversight by Congress. Just as Congress had to enact the Clayton Act in

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[32] Antitrust Modernization Commission Single-Firm Conduct Working Group, Memorandum at 16 (Dec. 21, 2004), at http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf.

[33] 127 S. Ct. at 2724 (emphasis added).

[34] *See id.* at 2732 ("Congress fully understood, and consequently intended … to make minimum resale price maintenance *per se* unlawful."); *see also* Herbert Hovenkamp, *Chicago and its Alternatives*, 1986 DUKE L.J. 1014, 1020 n.34 ("I am persuaded … that Congress has sanctioned the *per se* rule for resale price maintenance, and that we should feel obliged to comply with it until Congress tells us otherwise.").

1914 in response to the Court's narrowing of the Sherman Act in *Standard Oil,* and the Cellar-Kefauver Act in 1950 after the Court limited the Sherman Act again in *Columbia Steel*, Congress must once again rein in the Court and reestablish its primacy in making national competition policy for the benefit of consumers.

***Leegin* is Bad Policy**

The Court's repeal of the *per se* rule against RPM is bad policy for several reasons. First, the Court's standard for determining when to apply a *per se* rule was wrong. The Court concluded that the *per se* rule was not appropriate for RPM because, "[n]otwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance 'always or almost always tends to restrict competition and decrease output.'"[35] However, while that standard has been asserted in some cases,[36] it is the wrong test. Justice Breyer acknowledged that resale price maintenance can have procompetitive effects ("the proponents of a *per se* rule have always conceded as much"),[37] but "before concluding that courts should consequently apply a rule of reason, I would ask such questions as, how often are harms and benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?"[38] Modern decision theory dictates that the proper focus is not simply on the frequency with which a practice is anticompetitive or procompetitive, but also on the magnitude of the harms or benefits and, given error costs, whether an alternative rule would generally improve consumer welfare and the administration of the antitrust laws. As Professors Areeda and Hovenkamp have said, "It is thus not enough to suggest that a class of restraints is sometimes or even often beneficial or harmful.

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[35] 127 S. Ct. at 2717, *quoting* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988).

[36] *But see GTE Sylvania*, 433 U.S. at 50 n.16 ("Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them.").

[37] *Leegin*, 127 S. Ct. at 2732.

[38] *Id.* at 2729.

The critical questions are always ones of frequency and magnitude relative to the business and legal alternatives."[39]

Second, as explained below, while giving some credence to the anticompetitive effects of RPM, the Court understated the magnitude of the risks. Moreover, the Court ignored the fact that abandoning the *per se* rule in favor of the rule of reason will inevitably lead to an increased incidence of anticompetitive RPM, as well as increased uncertainty for business and greater litigation expenses. At the same time, the Court failed to show that the *Dr. Miles* rule harmed consumer welfare. The evidence that procompetitive uses of RPM are common or important is exceedingly thin. And insofar as RPM has procompetitive uses in theory, the evidence that less restrictive alternatives are more costly or less effective is nonexistent.

The Anticompetitive Effects of Resale Price Maintenance

The Court recognized that resale price maintenance "does have economic dangers."[40] What are those dangers?

Higher prices. The function of resale price maintenance is to raise resale prices to consumers, and there is little dispute that resale price maintenance generally has that effect.[41] This

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[39] 8 PHILLIP E. AREEDA & HEBERT HOVENKAMP, ANTITRUST LAW ¶1628b, at 292 (2d ed. 2004); *see also* Arndt Christiansen & Wolfgang Kerber, *Competition Policy With Optimally Differentiated Rules Instead of "Per se Rules vs. Rule of Reason"*, 2 J. COMP. L. & ECON. 215, 238 (2006) (explaining "error cost approach" in law and economics, and observing that to justify abandoning prohibition of RPM, "it is not sufficient to show that that there are cases in which resale price maintenance can lead to positive welfare effects"); Edward Iacobucci, *The Case for Prohibiting Resale Price Maintenance*, WORLD COMP. L & ECON. REV., Dec. 1995, at 71, 102 (advocating *per se* rule because "the number of cases where RPM is efficient will probably be rather small, while the cost involved from switching from RPM to alternatives is likely to be minimal [and] the cost of a rule-of-reason review is likely to be significant if it is to be done properly.").

[40] *Leegin*, 127 S. Ct. at 2719; *see id.* at 2717 ("[T]he potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated."); *id.* at 2716 ("[U]nlawful price fixing, designed solely to obtain monopoly profits, is an ever present temptation.").

[41] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604b, at 40 (resale price maintenance "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point."). Even the majority seemed to acknowledge this, *see* 127 S. Ct. at 2718 ("'price surveys indicate that [resale price maintenance] in most cases increased the prices of products sold'") (quoting THOMAS R.

would seem enough to make resale price maintenance competitively suspect,[42] and was the main reason Congress repealed the fair trade laws.[43] Studies of the fair trade era showed that prices of items subjected to fair trade in fair trade states were significantly higher than in states where resale price maintenance was illegal, and that fair trade cost consumers *billions* of dollars a year.[44] More recently, music companies' efforts to restrain resale prices of CDs was estimated by the FTC to have cost consumers as much as $480 million.[45]

The Court, however, was not impressed with the argument that resale price maintenance raises prices to consumers, "absent a further showing of anticompetitive conduct."[46] The Court suggested that since the high prices may be accompanied by more dealer services, it is not necessarily the case that resale price maintenance reduces consumer welfare.[47] Was Congress therefore misguided when it saw higher prices in fair trade states as being harmful to consumers? In the absence of other information, is it unreasonable to *presume* that higher prices resulting from resale price maintenance are indicative of consumer harm? I think not.

OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 160 (FTC Bureau of Economics Staff Report 1983)) (alteration in original), although the Court went on to say that resale price maintenance "may reduce prices if manufacturers have resorted to costlier alternatives of controlling resale prices that are not *per se* unlawful." *Id.*

[42] *See* Nat'l Soc'y of Prof'l Engineers v. United States, 435 U.S. 679, 692 (1978) ("[p]rice is the 'central nervous system of the economy'") (quoting United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940)).

[43] The 1975 Act itself is entitled, "An Act To amend the Sherman Antitrust Act to provide lower prices for consumers." 89 Stat. 801 (1975).

[44] *See* H. REP. NO. 94-341, at 3 (1975); *see also* F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy"*, COMP. POLICY INT'L, Autumn 2005, at 65, 71-74 (reviewing studies showing substantial consumer savings from termination of resale price maintenance in light bulb, retail drug, blue jeans, and other sectors).

[45] *See* Press Release, Fed. Trade Comm'n, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), http://www.ftc.gov/opa/2000/05/cdpres.htm.

[46] *Leegin*, 127 S. Ct. at 2718.

[47] *See id.* ("price surveys 'do not necessarily tell us anything conclusive about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive and anticompetitive theories'") (quoting OVERSTREET at 106) (alteration in original).

According to the Court, focusing on higher prices overlooks that a manufacturer ordinarily benefits from *low* resale prices. "As a general matter, therefore," the Court said, "a single manufacturer will desire to set minimum resale prices only if the 'increase in demand resulting from the enhanced service . . . will more than offset a negative impact on demand of a higher retail price.'"[48] However, an alignment between manufacturers' and consumers' interests cannot be generalized.[49]

Any congruence of manufacturer and consumer interests evaporates if the manufacturer adopts resale price maintenance at the behest of its retailers. Indeed, the Court noted, "If there is evidence that retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer."[50] The Court acknowledged that the risk of resale price maintenance being used to facilitate dealer collusion is a "legitimate concern."[51] Moreover, the Court recognized that, even without dealer collusion, a "manufacturer might consider that it has little choice but to accommodate [a powerful] retailer's demands for vertical price restraints if the manufacturer believes it needs access to the retailer's distribution network."[52] But while recognizing the anticompetitive retailer-power explanation for resale price maintenance, the Court seemed oblivious to the changes in the econ-

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[48] *Id.* at 2719 (quoting Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. IND. ORG. 57, 67 (1998)) (alteration in original).

[49] *See* Toys "R" Us, Inc. v. Fed. Trade Comm'n, 221 F.3d 928, 938 (7th Cir. 2000) (noting that rationale for permitting restricted distribution policies "depends on the alignment of interests between consumers and manufacturers. Destroy that alignment and you destroy the power of the argument.") (internal quotes omitted). Professor Cavanagh maintains that the argument that the manufacturer acts as a surrogate for the consumer "smacks of putting the fox in the chicken coop to protect the hens." Cavanagh, *supra*, at 20.

[50] *Leegin*, 127 S. Ct. at 2719 (citing Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* Supporting Neither Party, 2007 WL 173679, at 7-8, which states, "there are no arguments in economic analysis supporting restraints arising from distributor actions or pressures. In such circumstances, RPM and similar restraints lead to higher consumer prices with no demonstrated redeeming values . . . .").

[51] *Id.* at 2717.

[52] *Id.*

omy that have heightened the risk of retailer-induced resale price maintenance. For example, the Court emphasized that a single retailer cannot "abuse" resale price maintenance without "market power," and quoted the old saw from *Business Electronics* that "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers."[53] However, common sense says otherwise. Retail buyer power is common[54] and is increasing along with retail concentration.[55] As Justice Breyer pointed out, increased concentration in retailing "may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share."[56]

Lower retail prices may sometimes be in the manufacturer's interest, but sometimes the manufacturer can maximize its profits when RPM is used to *jointly* maximize the profits of the manufacturer and its retailers, or the manufacturer and its competitors. The Court conceded the danger that resale price maintenance might be used to facilitate a manufacturer cartel[57] but, significantly, failed to recognize that resale price maintenance may also facilitate oligopolistic pricing that may not itself be illegal.[58] The Court also did not acknowledge Justice Breyer's point

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[53] *Id.* at 2720 (quoting Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 727 n.2 (1988)) (alteration in original).

[54] *See, e.g.,* 8 AREEDA & HOVENKAMP, *supra,* ¶ 1604d3, at 48, 49 ("Multibrand dealers' ability to substitute other brands gives the dealers considerable leverage.").

[55] *See, e.g.,* Kris Hudson, *States Target Big-Box Stores -- Maine if First to Require that Wal-Mart, Rivals Undergo Impact Studies,* WALL ST. J., June 29, 2007, at A8 (reporting that in 2006, the ten largest U.S. retailers accounted for 25% of the nation's retail purchases, excluding cars, up from 18% in 1996).

[56] *Leegin*, 127 S. Ct. at 2733.

[57] *See id.* at 2716; *see also* Brief of *Amici Curiae* Economists in Support of Petitioner, *Leegin*, 2007 WL 173681, at 13 (objection "had some traction historically"); OVERSTREET, *supra,* at 22 ("The economics literature contains several examples of possible collusion among manufacturers which may have been facilitated by RPM.").

[58] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606d-f, at 86-92 (resale price maintenance reinforces manufacturer coordination, whether express or tacit, by reducing utility of wholesale price cuts and increasing

that "[i]ncreased concentration among manufacturers increases the likelihood that producer-originated resale price maintenance will prove more prevalent today than in years past, and more harmful."[59] Further, RPM may be used strategically to dampen interbrand price competition at the retail level even when competing manufacturers do not use RPM; competing single-brand retailers and multibrand retailers may respond to a manufacturer's use of RPM by raising the price of other brands.[60]

The Court also failed to recognize manufacturers' incentive independently to adopt resale price maintenance in order to protect their own wholesale margins. Retail discounting is often harmful to the manufacturer because it puts pressure on the manufacturer to reduce its wholesale prices.[61] As a Wal-Mart executive stated when Wal-Mart was the new discounter on the block, "I don't have any question but that competitive pricing at the retail level creates more pressure on manufacturers' factory prices than is present when they're able to set retail prices as well . . . ."[62]

Reduced efficiency and innovation. In addition to raising prices, resale price mainte-

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visibility of prices; "danger is more than theoretical"). Justice Breyer recognized that facilitation of tacit collusion was the main anticompetitive risk at the producer level. *See Leegin*, 127 S. Ct. at 2727.

[59] *Id.* at 2734.

[60] *See* Greg Shaffer, *Slotting allowances and resale price maintenance: a comparison of facilitating practices*, 22 RAND J. ECON. 120 (1991) ("legalizing RPM is tantamount to allowing retailers to commit to prices"). A recent study of Toyota's no-haggle pricing policy in Canada provides some empirical support for this phenomenon. *See* Xiaohua Zeng et al., The Competitive Implications of a "No-Haggle" Pricing Policy: The Access Toyota Case (Sep. 9, 2008) (unpublished manuscript), http://management.ucsd.edu/faculty/seminars/2008/papers/weinburg.pdf (finding that Toyota's uniform no-haggle pricing policy not only raised Toyota's retail prices in provinces where it was used, but Honda's as well).

[61] *See, e.g.,* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606c, at 85-86 (noting "instances in which intense price competition at the dealer level has led to price cuts at the manufacturing level"); Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L. J. 407, 441-42 (1997) (explaining that resale price maintenance may be used to tame the exercise of countervailing retail power).

[62] S. Robson Walton, *Antitrust, RPM, and the Big Brands: Discounting in Small-Town America (II)*, 15 ANTITRUST L. & ECON. REV. No. 2, at 11, 16 (1983).

nance has a tendency to reduce innovation and efficiency in retailing. As Justice Breyer noted, resale price maintenance agreements "can inhibit expansion by more efficient dealers whose lower prices might otherwise attract more customers, stifling the development of new, more efficient modes of retailing . . . ."[63] The majority recognized this effect when it noted, "Retailers with better distribution systems and lower cost-structures would be prevented from charging lower prices by the [RPM] agreement."[64] But while the majority was referring to resale price maintenance that is used to organize a retailer cartel,[65] the effect is inherent in resale price maintenance regardless of the purpose for which it is employed. The importance of this exclusionary theory of anticompetitive harm is highlighted by a recent study on the effect of eliminating RPM on books in the United Kingdom in the mid 1990s. In a report last year prepared for the Office of Fair Trading, researchers concluded that the abolition of RPM contributed to the entry and rapid growth of innovative forms of book retailing, namely Internet sellers and supermarkets.[66]

The Procompetitive Justifications for Resale Price Maintenance

Declaring that the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance,"[67] the Court identified three procompetitive jus-

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[63] *Leegin*, 127 S. Ct. at 2727; *see* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632c4, at 320 ("When resale prices are not fixed, price competition among dealers favors the expansion of those with efficient scale and methods, thus lowering the cost of distribution.").

[64] *Leegin*, 127 S. Ct. at 2717.

[65] *See id.* (also noting that "dominant retailer . . . might request resale price maintenance to forestall innovation in distribution that decreases costs").

[66] *See* OFFICE OF FAIR TRADING, AN EVALUATION OF THE IMPACT UPON PRODUCTIVITY OF ENDING RESALE PRICE MAINTENANCE ON BOOKS (Feb. 2008), *available* at http://oft.gov.uk/shared_oft/economic_research/oft981.pdf; *see also* Emanuele Givannetti & David Stallibrass, Three Cases in Search of a Theory: Resale Price Maintenance in the UK (2009) (unpublished manuscript) (noting that "study suggests that this growth of innovative book retailing in the UK would have been substantially slower absent the ability to offer discounted prices").

[67] *Leegin,* 127 S. Ct. at 2714.

tifications,[68] each of which is problematic.

Free rider theory. The principal theory discussed by the Court and relied upon by resale price maintenance advocates is the "free rider" theory, under which resale price maintenance can benefit consumers because the higher prices may induce retailers to provide pre-sale services that promote interbrand competition and otherwise would not be provided. Prominently featured in *Sylvania*, this theory (dating back at least to Telser in 1960) was well known to Congress in 1975 but nonetheless was rejected as a basis for permitting resale price maintenance.[69] As Justice Breyer noted, free riding is common in our economy; the real issue is "how often the 'free riding' problem is serious enough significantly to deter dealer investment."[70] Professors Comanor and Scherer in their *amicus* brief to the Court indicated "there is skepticism in the economic literature about how often" resale price maintenance "is needed to prevent free-riding and ensure that desired services are provided.[71] Klein and Murphy have noted that the standard free-rider theory for resale price maintenance is "fundamentally flawed" because it is based on "the unreal-

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[68] Justice Breyer said that the majority had listed just two theories, free rider and new entry. He did not accept the majority's contractual-fidelity theory, discussed *infra*.

[69] *See, e.g.,* S. REP. NO. 94-466, at 3 (1975) (noting that manufacturer could solve services problem "by placing a clause in the distributorship contract requiring the retailer to maintain adequate service. Moreover, the manufacturer has the right to select distributors who are likely to emphasize service."); *House Hearings, supra,* at 32 (statement of Thomas A. Rothwell, Executive Director and General Counsel of Marketing Policy Institute, quoting Bork's efficiency explanation for RPM).

[70] *Leegin*, 127 S. Ct. at 2729.

[71] Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* Supporting Neither Party, *Leegin*, 2007 WL 173679, at 6; *see also* F. M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 552 (3rd ed. 1990) ("relatively few products qualify . . . under Telser's free-rider theory"); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1601e, at 13 ("[U]nrestrained intrabrand competition does not lead to substantially detrimental free riding when dealers provide no significant services (such as drugstores selling toothpaste), the services they do provide cannot be utilized by customers who patronize other dealers (luxurious ambience), the services are paid for separately (post-sale repair), the services provided are not brand specific and are fully supported by a wide range of products (high-quality department store), the services can be provided efficiently by the manufacturer (advertising), or a sufficient number of consumers patronize the dealers from whom they receive the service."); *id.* ¶ 1611f, at 134 ("[F]or most products, low-service discounting dealers do not impair the viability of full-service dealers; both exist side by side.").

istic assumption that the sole avenue of nonprice competition available to retailers is the supply of the particular services desired by the manufacturer."[72] They have shown that, "[e]ven if the manufacturer fixes the retail price and does not permit price competition, retailers still have an incentive to free ride by supplying nonprice services that are not desired by the manufacturer but are of value to consumers,"[73] such as free gifts, free delivery, discounts on bundled products, rewards programs, and so forth. "No matter how large a margin is created by resale price maintenance, there appears to be no incentive for competitive free-riding retailers to supply the desired . . . services."[74]

The "quality certification" version of the free-rider theory cited by the Court[75] is even more problematic because the discounters are not even expected to offer the services of the prestige retailers, and thus have higher margins with which to continue to "free ride" by offering non-price inducements to attract customers from prestige retailers.[76] Furthermore, even if resale price maintenance is used to prevent free riding and increase output, there is no *a priori* reason to believe that consumers as a whole benefit, because most consumers may prefer the lower-priced

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[72] Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. LAW & ECON. 265, 266 (1988). Klein and Murphy were part of the group of *amici* economists supporting the reversal of *Dr. Miles*. *See* Brief of *Amici Curiae* Economists in Support of Petitioner, *supra,* App. 2a.

[73] Klein & Murphy, *supra*, at 266.

[74] *Id.*

[75] Under this version, discount retailers free ride on the reputation of prestige retailers for carrying only high-quality products. *See Leegin,* 127 S. Ct. at 2715-16 ("[C]onsumers might decide to buy the product because they see it in a retail establishment that has a reputation for selling high-quality merchandise.").

[76] *See* Iacobucci, *supra*, at 80-82; *see also* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1613d-g, 156-65 (maintaining that quality certification theory is "relatively weak" largely because elite dealers' services are unlikely to be driven from the market since they are not brand specific and the ambience of elite dealers is not subject to free riding; "distribution restraints in this context reflect the power of elite dealers rather than the manufacturer's desire").

product without the services.[77] As Justice Breyer noted, insofar as resale price maintenance agreements encourage dealers to compete on service instead of price, they threaten "wastefully to attract *too many* resources into that portion of the industry."[78]

Services without free-riding. The Court also maintained that resale price maintenance "can also increase interbrand competition by encouraging retailer services that would not be provided even absent free riding" because it "may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform."[79] The Court was apparently referring to Klein and Murphy's "contractual fidelity" theory, which is not so much about the difficulty of contractual specification, but rather about giving dealers excess profits to provide an incentive "for faithful performance of all the dealers' express or implied obligations."[80] Under this theory, the threat of termination or other contractual sanction may be an inadequate incentive against shirking by retailers if they are making only normal profits.[81] Putting aside the issue of why competition among retailers in the absence of free-riding would not be sufficient to ensure adequate dealer services,[82] this theory suffers from

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[77] *See* Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 4-5; *see also* Brief of *Amici Curiae* Economists, *supra,* at 10 (noting that Scherer & Ross have shown "that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding the impact on demand for the product").

[78] *Leegin*, 127 S. Ct. at 2727 (emphasis added).

[79] *Id.* at 2716.

[80] 8 AREEDA & HOVENKAMP, *supra,* ¶ 1614e, at 172; *see also* Mathewson & Winter, *supra*, at 74 ("The role of resale price maintenance in the Klein-Murphy explanation is to protect retailer quasi-rents against erosion by retail price competition, to ensure that contract termination has sufficient value as a threat.").

[81] Klein & Murphy, *supra*, at 268-69 (many dealers "make insufficient manufacturer-specific investments to insure dealer performance solely through the threat of losing the return on these specific investments").

[82] Justice Breyer did not credit this theory because, he said, "I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need resale price maintenance. Why, on these assumptions, would a dealer not 'expand' its 'market share' as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it. And I do not think that we should place significant weight upon justifications that the parties do not explain with sufficient clarity for a generalist judge to understand." *Leegin*, 127 S. Ct. at 2733. In fact, the contractual-fidelity theory does rely on a form of free riding or externality, either

several flaws. First, as with the standard free-rider theory, this theory is undermined by nonprice competition, which should have a tendency to eliminate the excess dealer profits on which the theory is predicated.[83] Second, as with any resale price maintenance scheme designed to raise dealer margins, the result is likely to harm consumers of multibrand retailers insofar as those retailers steer consumers to high-margin, price-maintained products regardless of their competitive merits.[84] Third, if the goal is merely to increase the rents earned by dealers, then there are less restrictive alternatives, such as lump-sum payments.[85] Finally, it is not obvious that this theory has any empirical significance; how many manufacturers in the real world look to provide supranormal profits to their distributors so that the threat of termination in the case of noncompliance is meaningful?

New entrant theory. The third procompetitive justification discussed by the Court is the "new entrant" justification.[86] Quoting *Sylvania*, the Court suggested that resale price mainte-

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between dealers as under the traditional theory, or between the manufacturer and the retailer. *See* Klein & Murphy, *supra*, at 281 (noting that dealer may free ride on manufacturer's reputation). The theory responds to the criticism of the traditional free-rider theory that RPM is unnecessary if (and ineffective unless) manufacturers can contractually require retailers to provide services. Klein and Murphy suggest that contractual specification may not be enough to motivate dealers or may not be practical. For a further discussion of the specification point, see *infra.*

[83] *See* Ittai Paldor, Rethinking RPM: Did the Courts Have it Right All Along? 199-202 (June 25, 2007) (unpublished S.J.D. thesis, University of Toronto) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=994750.

[84] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1614a-d, at 165-71 (rejecting dealer goodwill as justification for RPM because providing multibrand retailers with higher margin to push particular brand leads to deception of consumers and reflects retailer power); LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 6.3c2, at 343 (2006) (noting multibrand retailers' incentives to steer consumers away from brands that offer lower margins even if those brands are competitively superior).

[85] *See* Paldor, *supra,* at 204-08; Iacobucci, *supra*, at 88.

[86] The majority mentioned a fourth theory by way of citing Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q. J. ECON. 885 (1996), which the Court described as "noting that resale price maintenance may be beneficial to motivate retailers to stock adequate inventories of a manufacturer's goods in the face of uncertain consumer demand[]." *Leegin*, 127 S. Ct. at 2716. Under this theory, RPM assures dealers that if demand turns out to be low they will not be forced to liquidate their inventory at fire-sale prices, which induces the dealers to stock sufficient inventory to

nance can facilitate new entry by "'induc[ing] competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.'"[87] This theory has been questioned by scholars because other tools (such as restricted distribution) are usually more effective in ensuring that "Johnny-come-lately" stores will not siphon off the rewards that pioneering dealers need for their "missionary work."[88] And whatever benefits there may hypothetically be from RPM inducing new entry, it is quite likely substantially outweighed by the ability of RPM-controlled retailers to block new retailer entry, where price discounting is a traditional and frequently used strategy. In any event, this rationale, if convincing, could easily be accommodated by a limited exception to the *per se* rule, as Justice Breyer suggested,[89] although such an exception was expressly rejected by Congress in 1975.[90]

Brand image. Notably, the Court did not include preservation of "brand image" as a pro-

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cover a high demand. This theory does not necessarily benefit consumers, as the authors note, because it deprives consumers of the surplus that would be obtained in the low demand state absent RPM, which may exceed the surplus with RPM. *See* Deneckere et al., *supra*, at 887 ("[I]n contrast to other efficiency-based theories of RPM . . . in which manufacturer and consumer interests roughly coincide, we show that manufacturer benefits can often come principally from consumer surplus."). Moreover, it assumes that the alternative of paying dealers for unsold inventory in the event of low demand is more costly than enforcing RPM, which is questionable. *See* Paldor, *supra*, at 211-21 (critiquing demand uncertainty hypothesis).

[87] *Leegin*, 127 S. Ct. at 2716 (quoting Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)). Interestingly, this theory is not typically one of the procompetitive justifcations offered by economists. *See, e.g.,* Brief of *Amici Curiae* Economists, *supra* (citing free-rider, contractual-fidelity, and demand-uncertainty theories).

[88] Steiner, *supra*, at 430; *see also* Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 CALIF. L. REV. 817, 849 (1992) (maintaining that less restrictive alternatives are available for new entrants to gain dealer loyalty); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1617a3, at 195-96 (while new-entry rationale makes sense as a justification for exclusive territories, it "seems presumptively inapplicable to resale price maintenance").

[89] *See Leegin*, 127 S. Ct. at 2731 (Justice Breyer stating that if he were starting from scratch, he "might agree that the *per se* rule should be slightly modified to allow an exception for the more easily identifiable and temporary condition of 'new entry.'") (citing Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1495 (1983)).

[90] *See* H. REP. NO. 94-341, at 5 (1975).

competitive justification, notwithstanding that it is often cited by manufacturers, including Leegin itself.[91] As Professors Areeda and Hovenkamp explain, "Manufacturers often say that price discounting 'cheapens' their product image and thereby destroys the goodwill that the manufacturer has developed for its product through skillful advertising and marketing. . . . [But u]nless connected with dealer services . . . the claim does not appear to be a powerful one."[92] This theory rests on the generally implausible assumption that the demand for the good is upward sloping, although particular retailers are able to increase output by lowering price.[93] Insofar as this assumption is based on the proposition that consumers erroneously believe that a higher price itself reflects higher quality (or that a lower price itself reflects lower quality), then it amounts to a frontal assault on the basic policy of the Sherman Act and the Federal Trade Commission Act, which is that consumers are sovereign and must be assumed, when reasonably informed, to make rational decisions in a competitive marketplace. Indeed, Congress rejected this theory as a justification for fair trade because "the marketplace should be allowed to judge the value of a 'brand image' without the restraints imposed by resale price maintenance."[94] Even if "snob appeal," or conspicuous consumption, might support an upward-sloping demand curve in some circumstances, such a rationale is not a legitimate justification for RPM because it is difficult to disentangle from the effects arising from deception, and conspicuous consumption offers no intrinsic benefit for consumers. Moreover, a high-price image can be controlled by

[91] See *Leegin*, 127 S. Ct. at 2711 (Leegin "expressed concern that discounting harmed Brighton's brand image and reputation."). It was also cited by Nine West. *See* Letter from the American Antitrust Institute to Deborah Platt Majoras, Re: Petition of Nine West Footwear Corp. to Reopen and Modify Order, FTC File No. 981-0386 (Dec. 5, 2007), *available at* http://www.antitrustinstitute.org/Archives/9W.ashx ("AAI *Nine West* Letter"); *see also* Henry & Zelek, *supra*, at 8 ("Significant discounting of a product can adversely affect the manufacturer, its resellers and the product itself by eroding brand image . . . .").

[92] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1631a1, at 306; *see id*. ¶ 1633d2(A), at 335 (would reject protection of manufacturer goodwill as a justification for RPM, at least presumptively).

[93] *See id.* ¶ 1613c, at 156 (postulated upward-sloping demand curve has little empirical support).

[94] H.R. Rep. No. 94-341, at 5 (1975).

setting the wholesale price or by restricting distribution to high-end retailers, without the anticompetitive side effects of RPM.[95]

Empirical Evidence

What of the empirical evidence? The Court concluded, "although the empirical evidence on the topic is limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical" and thus "the [*per se*] rule would proscribe a significant amount of procompetitive conduct . . . ."[96] The dissent disagreed. Justice Breyer could "find no economic consensus" on how often resale price maintenance will be beneficial in practice.[97] The majority cited two "recent" empirical studies of litigated cases.[98] One by Pauline Ippolito, published in 1991, reviewed all cases (public and private) reported between 1976 and 1982 that included resale price maintenance claims.[99] The other by Thomas Overstreet, issued by the FTC in 1983, reviewed the 68 resale price maintenance cases brought by the FTC that were resolved between 1965 and 1982.[100]

Ippolito concluded that the cases were generally not consistent with dealer or manufac-

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[95] *See* OVERSTREET, *supra*, at 61 n.1 ("[I]n the snob appeal case it is not obvious why RPM would be necessary because the manufacturer could insure high prices without RPM."); Pitofsky, *supra*, at 1494.

[96] *Leegin*, 127 S. Ct. at 2717-18.

[97] *Id.* at 2729.

[98] *Id.* at 2715, 2717.

[99] *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J. LAW & ECON. 263, 266 (1991) [Ippolito, *RPM*]. Ipppolito's work was originally published as a staff report of the Federal Trade Commission Bureau of Economics. *See* PAULINE M. IPPOLITO, RESALE PRICE MAINTENANCE: ECONOMIC EVIDENCE FROM LITIGATION (FTC Bureau of Economics Staff Report 1988) [IPPOLITO, STAFF REPORT]. Her sample consisted of 73 cases brought by federal or state enforcement agencies and 130 private cases, about 30% of which involved maximum RPM claims. *See* Ippolito, *RPM*, *supra*, at 268-69. Information about the cases came from judicial opinions and consents reported in the CCH Trade Cases reporter. *See id.* at 266.

[100] *See* OVERSTREET, *supra* note 97, at 63. Many of the FTC cases reviewed by Overstreet are also in the Ippolito sample. *Compare id*. at 92-100 *with* IPPOLITO, STAFF REPORT, *supra*, at Table A1.

turer cartel theories,[101] but Justice Breyer noted that "this study equates failure of plaintiffs to *allege* collusion with the *absence* of collusion – an equation that overlooks the superfluous nature of allegations of horizontal collusion in a resale price maintenance case that would be tried under the *per se* rule, and the tacit form that such collusion might take."[102] Ippolito also concluded that the "special services," or free rider theory, "has the *potential* to be a major explanation for RPM-type practices"[103] based on the fact that 50 percent of the private cases and 42 percent of the government cases involved what she categorized as "complex products," i.e. "products for which quality and use information were nontrivial issues prior to purchase and where the information was not specific to the retailers' goods."[104] This can hardly be described as "evidence" that free riding was involved in any of these cases; at most it suggests that free riding could not be ruled out.

In his study, Overstreet concluded that "RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel" based on the fact that in 47 cases where data were available, over 80 percent involved products with more than 200 dealers.[105] But large numbers do not necessarily indicate low con-

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[101] *See* Ippolito, *RPM*, *supra* note 148, at 281 (noting that only 13% of the sample included allegations of horizontal price fixing). *But see* IPPOLITO, STAFF REPORT, *supra*, at 53 (45% of RPM cases brought by DOJ involved allegations of horizontal price fixing).

[102] *Leegin*, 127 S. Ct. at 2732 (citing HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY § 11.3c, at 464 & n.19 (3d ed. 2005)) (making similar criticism). Ippolito's assumption was that "if the plaintiff had any evidence that the practice at issue in the litigation was used to support collusion, we would expect to see horizontal price-fixing allegations in these cases, in addition to the RPM allegation." Ippolito, *RPM*, *supra*, at 281. This raises the question of the validity of drawing any inferences about the actual *practice* of RPM from private cases with RPM *allegations*, when RPM may not have been present at all in many of the cases. *See* Brunell, *supra*, at 509 n. 151.

[103] Ippolito, *RPM, supra,* at 285 (emphasis added).

[104] *Id.* at 283; *see id.* at 284 (categorizing as complex such products as printing, funeral insurance, and television sets).

[105] OVERSTREET, *supra*, at 80 ("Widespread dealer collusion involving more than 100 (or 200) decision makers seems unlikely to be effective or persistent in the absence of restrictions on entry such as licensing requirements or some mechanism for overt coordination such as an active trade association."). Overstreet

centration or the absence of a dominant dealer or a small number of dominant dealers, and the study does not consider whether resale price maintenance may have been limited to local markets in which dealer concentration was high.[106] Moreover, some of the best-documented instances of resale price maintenance in history, such as those involving retail druggists, involved dealer cartels in highly unconcentrated markets.[107] Overstreet did not look for indications of procompetitive explanations of resale price maintenance,[108] and recognized that the information he used for his study was generally "inadequate to determine rigorously whether the associated economic conditions correspond best with procompetitive or anticompetitive hypotheses about the use of RPM."[109] Neither Ippolito nor Overstreet considered whether dealer pressure without collusion might have accounted for any of the instances of resale price maintenance. In sum, neither of these antiquated "new" studies does much to fill "the dearth of empirical evidence" on the effects of resale price maintenance noted by Ippolito.[110] However, many commentators agree with

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also concluded that manufacturer collusion was an unlikely explanation for most of the cases, since "a good deal of the RPM reflected in FTC cases has occurred among small firms selling in markets that are structurally competitive." *Id.* at 78; *see id.* at 73 (finding only 24.4% of cases had four-firm concentration in excess of 50%, measured using 5 digit S.I.C. product classes).

[106] *See id.* at 80 ("Whether local dealer collusion (or monopsony) could explain particular instances of RPM cannot presently be determined from the general information in the case files.").

[107] *See* Thomas R. Overstreet Jr. & Alan A. Fisher, *Resale Price Maintenance and Distributional Efficiency: Some Lessons from the Past*, 3 CONTEMP. POL'Y ISSUES 43, 49-50 (1985) (noting that, contrary to predictions of economic analysis, retail druggists cartel "achieved virtually universal compliance with a price-fixing policy–despite very large numbers and an extremely unconcentrated market").

[108] *See* OVERSTREET, *supra*, at 66-68. The Court quoted Overstreet's conclusion that "'[e]fficient uses of [resale price maintenance] are evidently not unusual or rare,'" *Leegin*, 127 S. Ct. at 2715 (alteration in original), but this conclusion seems to be based on his determination that his study and the prior studies that he reviewed did not show that dealer and manufacturer collusion always or almost always explained RPM, rather than any studies affirmatively demonstrating efficient uses of RPM. *See* OVERSTREET, *supra*, at 165-67.

[109] *Id.* at 66. Indeed, Overstreet noted that the case records "generally contain only limited information concerning the scope of particular RPM programs and the extent to which they were enforced," *id*., and most files had "no description of the RPM practices of competitors." *Id.* at 67.

[110] Ippolito, *RPM, supra*, at 293 ("The current dearth of empirical evidence on the use of vertical restraints and of RPM in particular seriously limits the development of economic understanding of these practices.").

Overstreet's later observation that "the historical experience, or practice of RPM [is] largely a sorry record of abuses, in sharp contrast to the contention of RPM's missionaries."[111]

Less Restrictive Alternatives

Perhaps the most glaring flaw in the majority's analysis is its failure to consider whether any procompetitive effects of resale price maintenance can be achieved by less restrictive means that do not prevent efficient retailers from passing on their lower costs to consumers. If so, then the costs of the *per se* rule would be minimal. *Amici* economists recognized that manufacturers may curtail free riding by other means, and that where such means are available, "RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition."[112] The most obvious way to ensure desired retailer services is to pay retailers for performing those services, using promotional allowances or other marketing techniques.[113] There is no empirical evidence whatsoever that such techniques are more costly or less effective than resale price maintenance in obtaining dealer services,[114] which is perhaps why the Court ignored the point.[115] To be sure, promotional allowances for services may ultimately

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[111] Overstreet & Fisher, *supra*, at 45; *see also* Brunell, *supra*, at 511 n.160 9 (citing additional sources).

[112] Brief of *Amici Curiae* Economists, *supra*, at 9.

[113] *See, e.g.,* Toys "R" Us, Inc. v. Fed. Trade Comm'n, 221 F.3d 928, 933, 938 (7th Cir. 2000) (rejecting free-rider argument because services performed by retailer, such as advertising, warehousing and full-line stocking, were compensated by manufacturer).

[114] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632b at 318 ("there are few documented instances of significantly impaired distribution" as a result of ban on RPM).

[115] The Robinson Patman Act is no impediment to reimbursing retailers for services that benefit the supplier. *See* Richard M. Steuer, *Dysfunctional Discounts,* ANTITRUST, Spring 2005, at 75, 79. *Amici* economists maintained that paying dealers for services may not be as efficient as RPM "*under some circumstances*" because "it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them," or because it is "possible that the retailer, rather than the manufacturer, knows which retail-level services will be the most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer." Brief of *Amici Curiae* Economists, *supra*, at 9 (emphasis added). However, no evidence was offered as to the empirical significance of these possibilities. It is not apparent why a retailer would choose to provide services that the manufacturer has not even asked for when other retailers are not also required to provide such serv-

also raise consumer prices to account for the cost of the services, but unlike resale price maintenance, such payments do not prevent discounting that reflects more efficient retailers' lower costs of doing business. As New York's Solicitor General pointed out at oral argument, "It's a question really of what kind of currency a manufacturer can use to buy those retailer services."[116]

The Court missed this simple truth, as is evident in its critique of the argument that resale price maintenance should be considered anticompetitive merely because it raises prices:

> The implications of respondent's position are far reaching. Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices. The same can hold true for resale price maintenance.[117]

But the difference between resale price maintenance and these other quality-enhancing activities that also raise prices is that, even assuming that resale price maintenance in theory can be used to increase demand, it comes with an anticompetitive weight attached: it always prevents more efficient retailers from cutting prices based on their lower costs. And, of course, these other activities raise demand directly, and only indirectly raise prices, while resale price maintenance raises prices directly and only indirectly may lead to the hoped-for benefits.

Costs of the Rule of Reason

The majority acknowledged that "the *per se* rule can give clear guidance for certain con-

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ices, unless the services themselves are profitable for a retailer, which means that resale price maintenance is not necessary in the first place.

[116] Transcript of Oral Argument, *Leegin*, 2007 WL 967030, at 48 (Mar. 26, 2007) (Barbara Underwood).

[117] *Leegin*, 127 S. Ct. at 2719.

duct"[118] and "may decrease administrative costs,"[119] but minimized the significance of the issue by asserting that "[a]ny possible reduction in administrative costs cannot alone justify the *Dr. Miles* rule."[120] But no one had argued they did. Justice Breyer contended that the administrative costs of a rule of reason would be significant, and militated strongly in favor of retaining the *per se* rule. And the cost of the rule of reason is not simply uncertainty and adjudication costs, but the "false negatives" that result from making it significantly more difficult to bring a successful resale price maintenance suit.

Although the Court said that the lower "courts would have to be diligent in eliminating . . . anticompetitive uses [of RPM] from the market,"[121] and instructed them to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,"[122] Justice Breyer pointed out that will not be an easy exercise. The Court suggested three relevant considerations for the rule of reason – number of manufacturers using the restraint, source of the restraint, and market power – but the Court's obtuse three paragraphs of instruction offer little guidance and likely will exonerate many anticompetitive uses of resale price maintenance.

The Court said the "number of manufacturers that make use of the practice in a given in-

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[118] *Id.* at 2713.

[119] *Id.* at 2718.

[120] *Id.* The Court pointed out that *per se* rules "can increase the total cost of the antitrust system by prohibiting procompetitive conduct the antitrust laws should encourage." *Id.* And, gilding the lily, added, "They also may increase litigation costs by promoting frivolous suits against legitimate practices." *Id.* Of course, if the practice is deemed *per se* illegal, then it is not legitimate under the law and suits challenging it can hardly be considered frivolous. The nature of *per se* rules is that they are overinclusive and lead to false positives. The Court seemed to think that the rule of reason leads to more accurate results, but that is not necessarily the case, as noted in the text.

[121] *Id.* at 2719.

[122] *Id.* at 2720.

dustry can provide important instruction,"[123] for widespread coverage of resale price maintenance may facilitate a manufacturer's cartel,[124] or deprive consumers of meaningful choice.[125] But the Court did not acknowledge the difficulties of determining the extent of coverage when local variation and "informal" resale price maintenance are considered, as they should be.[126] Nor did the Court offer guidance on the extent of market coverage that may be considered problematic. In a concentrated market, coverage need not be extensive to trigger concern about manufacturer coordination.[127] The FTC entirely ignored the "market coverage" factor in its *Nine West* decision, even though Nine West had maintained that one reason it wished to use RPM was that many of its competitors were doing so.[128]

The Court allowed that the "source of the restraint may also be an important considera-

[123] *Id.* at 2719.

[124] As noted above, the Court did not acknowledge that resale price maintenance can facilitate oligopoly pricing. If cartel facilitation were the only issue, then it would be difficult to quarrel with the arguments of RPM proponents that RPM needs no independent legal sanction.

[125] *Id.* at 2719 (quoting Scherer and Ross to the effect that widespread coverage of RPM "'depriv[es] consumers of a meaningful choice between high-service and low-price outlets'"); *see also* Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 9 (noting that with widespread market coverage "consumer choice is restricted to goods with bearing high distribution margins" and dealer promotional efforts will "largely cancel each other out in the aggregate, leading to a high-price, high-margin, high promotional cost equilibrium with relatively little if any expansion of demand.").

[126] Areeda and Hovenkamp argue persuasively that "[i]n measuring market coverage, vertically integrated firms should be counted among those using the vertical restraint, along with firms controlling resale prices informally." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606g6, at 96. But they note the difficulties of determining market coverage "because a suit involving one or a few manufacturers will seldom offer reliable information about other manufacturers' vertical restraints, especially their informal ones." *Id.*, ¶ 1632d2, at 322. Market coverage must be assessed at the local level if consumers' ability to avoid price-maintained products is taken seriously.

[127] *See id.* ¶ 1606g5, at 96 (danger of use of RPM to facilitate manufacturer coordination in concentrated market "does not disappear" at market coverage between 10-50 percent); Brief for William S. Comanor & Frederic M. Scherer, *supra*, at 10 (suggesting presumption of illegality in concentrated markets where RPM is implemented by seller with at least 10 percent market share; "[f]ocusing on oligopolistic sellers' market structure is appropriate because under oligopoly, imitation of one leading seller's marketing strategy by other sellers is more likely").

[128] *See* AAI *Nine West* Letter, *supra*; *see also* Howard P. Marvel, *Resale Price Maintenance and the Rule of Reason*, ANTITRUST SOURCE, June 2008, at 8, http://www.abanet.org/antitrust/at-source/08/06/Jun08-Marvel6=26f.pdf ("The willingness to dismiss the possibility of a manufacturer cartel is somewhat surprising, given the widespread use of RPM in conjunction with the sale of women's shoes.").

tion,"[129] but Justice Breyer pointed out that "it is often difficult to identify *who* – producer or dealer – is the moving force behind any given resale price maintenance agreement."[130] More fundamentally, one does not need a retailer cartel or a "dominant, inefficient retailer," as the Court suggests,[131] to find retail buyer power or to conclude that RPM is a product of such power rather than an effort to promote distribution efficiencies. The FTC also gave short shrift to this factor in *Nine West* when it apparently accepted at face value Nine West's assertion that "it is responsible for its desire to engage in resale price maintenance."[132]

The Court indicated that market power is important,[133] and some commentators and lower courts have interpreted *Leegin* to adopt a manufacturer market-power screen.[134] However, the absence of traditionally-defined market power (i.e., significant market share) on the part of the manufacturer does not mean that resale price maintenance is harmless.[135] Manufacturers

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[129] *Leegin*, 127 S. Ct. at 2719.

[130] *Id.* at 2730.

[131] According to the Court, "If there is evidence that retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer. . . . If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct." *Id.*

[132] FTC Nine West Order, *supra*, at 15.

[133] The Court said that under the rule of reason in general, "[w]hether the businesses involved have market power is a . . . significant consideration." *Leegin*, 127 S. Ct. at 2712.

[134] *See* Fiala & Westrich, *supra*, at 4 ("Although the Court in *Leegin* did not expressly sanction the adoption of a market power screen at the pleading stage, there is some support in the opinion for such an approach."); Michael L. Denger & Joshua Lipton, *The Rule of Reason and* 'Leegin *Policies': The Supreme Court's Guidance*, ANTITRUST, Fall 2007, at 45, 46 ("[A] finding of market power is a necessary–but not sufficient–prerequisite to a finding that a single manufacturer's use of resale price maintenance is anticompetitive.").

[135] The Court said that "if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets," *Leegin*, 127 S. Ct. at 2720, but the use of resale price maintenance to obtain exclusive dealing has never been one of the main concerns of RPM. *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632c, at 319-21. The lack of market power has been thought to be important to resale price maintenance because, in the absence of brand market power at the local level, RPM cannot be used to raise retail prices.

with relatively small market shares but powerful brands may have significant market power. [136] Indeed, it is commonly understood by economists that neither retailers nor manufacturers will engage in resale price maintenance without some interbrand market power.[137] In all events, as Justice Breyer noted, the "Court's invitation to consider the existence of 'market power' . . . invites lengthy time-consuming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets."[138] Or worse, courts will simply dismiss the complaint out of hand under the restrictive *Twombly* pleading rules because of insufficient allegations of market definition, as I noted at the outset several have already done.

Finally, the Court declined to offer guidance on how courts are to consider the procompetitive side of the rule of reason equation. While the Court identified certain procompetitive theories, it did not suggest how a manufacturer may prove them, perhaps because as Justice Breyer observed, "it is difficult to determine just when, and where, the 'free riding' problem is serious enough to warrant legal protection."[139] Nor did the Court indicate whether less restrictive alternatives should be considered, or how any procompetitive justification should be balanced against anticompetitive effects.

The upshot of the Court's decision, besides leaving businesses and the lower courts largely at sea, is that the private bar and public enforcers will be reluctant to bring cases. As Pro-

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[136] S*ee* SULLIVAN & GRIMES, *supra*, § 7.3a1, at 384-88. Likewise, multibrand retailers with relatively modest market shares may have significant buyer power. *See* Brunell, *supra*, at 499 n.110.

[137] *See* Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 849 (1955) ("Price maintenance appears to be incompatible with an assumption of pure competition among both sellers and resellers."); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632e2, at 324-25 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products"). Accordingly, the presence of resale price maintenance may itself be some evidence of market power.

[138] *Leegin*, 127 S. Ct. at 2730; *see* Pitofsky, *supra*, at 1489 (noting that definition of relevant product and geographic markets is "a complicated and extremely elaborate economic inquiry in itself").

[139] *Leegin*, 127 S. Ct. at 2730.

fessor Pitofsky has noted, "rule of reason cases often take years to litigate[,] are extremely expensive" and are "very difficult for a plaintiff (either the government or a private party) to win . . . ."[140] Most commentators agree that the rule of reason, as applied by the lower courts to nonprice vertical restraints, has resulted in a rule of virtual *per se* legality.[141] The early dismissal of RPM claims on the pleadings suggests that the same rule may result for RPM.[142] Even if the lower courts are more diligent about RPM, the cost and uncertainty of undertaking a rule of reason case will no doubt mean that businesses will be more apt to engage in anticompetitive RPM, and many instances of anticompetitive resale price maintenance will go unremedied. Moreover, manufacturers that face pressure from retailers to adopt resale price maintenance will no longer be able to just say "no, it's illegal."[143]

The Dichotomy Between Price and Nonprice Restraints

One of the rationales for the Court's decision was that there is "little economic justification for the current differential treatment of vertical price and nonprice restraints,"[144] notwithstanding that the Court in *Sylvania* had said "[t]here are . . . significant differences that could

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[140] Pitofsky, *supra,* at 1489.

[141] *See, e.g.,* Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991). Plaintiffs cannot win nonprice restraints cases not because such restraints are never anticompetitive, but rather because the hurdles for recovery are so high. Not only must plaintiffs jump through the "agreement" hoops that the Court established for resale price maintenance, *see, e.g.,* Parkway Gallery Furn., Inc. v. Kittinger/Pennsylvania House Group, Inc., 878 F.2d 801 (4th Cir. 1989), but lower courts have ordinarily required plaintiffs to make a threshold showing that the manufacturer has market power and "[m]ost cases have made clear that power will not be inferred unless the defendant's market share is significant." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1645c, at 404-05.

[142] Professor Blair concludes that the lack of practical guidance offered by the Court in light of the intractable difficulties of determining when promotional use of RPM advances consumer welfare suggests that "the Court intended to make RPM per se legal without actually saying so." Roger D. Blair, *The demise of* Dr. Miles: *Some troubling consequences*, 53 ANTITRUST BULL. 133, 151 (2008).

[143] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1632b, at 319 ("There is little doubt that per se illegality strengthens the hands of manufacturers in resisting dealer demands for price protection.").

[144] *Leegin*, 127 S. Ct. at 2723.

easily justify different treatment."[145] In fact, different treatment is justified because, as Areeda and Hovenkamp explain, "Nonprice restraints fulfill a wider range of potentially legitimate objectives and threaten fewer harms to competitive interests" than resale price maintenance.[146] The Court in *Sylvania* had noted that unlike nonprice vertical restraints, vertical price agreements "almost invariably" reduce interbrand competition.[147] Indeed, resale price maintenance agreements *are* more likely than nonprice restraints to restrict interbrand competition at both the retailer and manufacturer levels. At the retailer level, only resale price maintenance restricts retailers from competing on price *against other brands*.[148] And resale price maintenance, unlike nonprice restraints, prevents more efficient retailers from passing on the benefits of that efficiency to consumers.[149] Furthermore, by restricting an important competitive tool, resale price maintenance stultifies "interbrand" competition among multibrand retailers, which are generally not susceptible to territorial or customer restraints.[150] As a general matter, "[t]he form of restraint

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[145] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.18 (1977). The *Leegin* majority dismissed this "footnote" on the basis that "the central part of the opinion relied on authorities and arguments that find unequal treatment 'difficult to justify,'" quoting Justice White's concurring opinion. 127 S. Ct. at 2721. But the *Sylvania* majority expressly referred to Justice White's argument and rejected it. *See Sylvania*, 433 U.S. at 51 n.18.

[146] 8 AREEDA & HOVENKAMP, *supra*, ¶ 1630b, at 302; *id.* at 303 ("It is . . . entirely reasonable to regard resale price maintenance as a more pervasive threat to competition than nonprice restraints."). The fact that the Court saw fit to articulate guidelines for the rule of reason that are arguably more stringent than the rule of reason applicable to nonprice restraints underscores that different treatment is warranted.

[147] *Sylvania*, 433 U.S. at 51 n.18 (quoting Justice Brennan's concurring opinion in *White Motor*).

[148] Even airtight territorial exclusives, while more restrictive of intrabrand competition, allow restricted dealers to compete fully in their territories against dealers of other brands. But RPM prevents restricted dealers "from engaging resellers of other brands in price competition." 8 AREEDA & HOVENKAMP, *supra*, ¶ 1630b, at 303.

[149] *See* Arthur H. Travers, Jr. & Thomas D. Wright, Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795, 801 (1962) (noting that territorial and customer restraints do not have "settled propensity of resale price maintenance to prevent dealers or distributors from passing the benefits of efficient distribution on to consumers by adopting a high-volume, low-markup policy") (cited with approval in White Motor Co. v. U.S., 372 U.S. 253, 268 n.7 (1963) (Brennan, J., concurring)).

[150] *See* 8 AREEDA & HOVENKAMP, *supra*, ¶ 1604g6, at 65.

most likely to reflect dealer power is resale price maintenance."[151] The Court in *Sylvania* also distinguished price and nonprice vertical restraints on the ground that price restraints, unlike nonprice restrains, can facilitate a manufacturers' cartel.[152]

Besides doing less harm, nonprice vertical restraints are more likely to have procompetitive benefits than vertical price restraints might have. Nonprice vertical restraints have a wider range of legitimate justifications, including ensuring efficient dealer scale, focusing dealer effort on developing classes of customers or territories, and promoting product quality and safety.[153] Moreover, to the extent that territorial or customer restraints entirely eliminate intrabrand competition, such restraints are more likely than resale price maintenance agreements to solve free-rider problems.[154] In short, it makes sense to apply a more stringent standard to RPM than to nonprice vertical restraints.

The vast majority of advanced industrial countries generally ban minimum RPM and treat it more harshly than nonprice vertical restraints.[155] For example, the European Union, which

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[151] *Id.*; *see also id.* ¶ 1630b, at 303 ("Historically . . . price rather than nonprice restraints have been the vehicle chosen by dealer organizations to limit competition among their members.").

[152] *See Sylvania*, 433 U.S. at 51 n.18; *see also* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 725-26 (1988) (noting that authorities cited by *Sylvania* suggested RPM may assist cartelization, but "[s]imilar support for the cartel-facilitating effect of vertical nonprice restraints was and remains lacking"); 8 AREEDA & HOVENKAMP, *supra*, ¶ 1606h, at 99 ("[M]ost nonprice restraints lack the characteristics that enable resale price maintenance to support price coordination among manufacturers.").

[153] *See id.* ¶ 1647 (reviewing justifications for nonprice restraints); *Sylvania*, 433 U.S. at 55 n.23 (noting that nonprice restraints may be used by manufacturers to ensure compliance with product safety and warranty responsibilities).

[154] *See* SULLIVAN & GRIMES, *supra*, § 6.3b, at 338; Ittai Paldor, The Vertical Restraints Paradox: Justifying the Different Legal Treatment of Price and Non-price Vertical Restraints 36 (Jan. 29, 2007) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=951609. As long as dealers still compete, as they do under resale price maintenance (but not under airtight territorial exclusivity), they have the incentive and ability to free ride on service-providing dealers by offering free shipping, discounts on bundled items, and so forth. Of course, as noted above, territorial exclusives are impractical for multibrand retailers.

[155] *See* ORGANISATION FOR ECON. CO-OPERATION AND DEV., ROUNDTABLE ON RESALE PRICE MAINTENANCE 2 (2008) [OECD RPM REPORT] (reporting that per se approach to RPM "persists in nearly every OECD country").

liberalized its treatment of most nonprice restraints, continues to treat minimum RPM as a "hard-core" restraint, equivalent to being almost *per se* illegal.[156] Individual member states, many of which led the Untied States in abolishing fair trade, follow suit.[157] The fact that most of the rest of the advanced industrialized world apparently recognizes the wisdom of some form of *per se* approach underscores the lack of consensus on the *Leegin* rule.[158]

Tension With the *Colgate* Doctrine

The Court thought that the *Colgate* doctrine, which permits manufacturers "unilaterally" to impose RPM by terminating retailers that do not follow its suggested prices, militated in favor of repealing *Dr. Miles*. After all, if the "economic effects of unilateral and concerted price setting are in general the same,"[159] what is the justification for making one *per se* legal and one *per se* illegal? It only pushes manufacturers that wish to set retail prices to adopt wasteful or seemingly irrational measures to get into the former category, according to the Court.[160] Moreover,

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[156] EU law creates a strong presumption of illegality, but this presumption is rebuttable if the firm in question establishes the agreement is indispensible to the achievement of substantial efficiencies that benefit consumers. *See* Luc Peeperkorn, *Resale Price Maintenance and its Alleged Efficiencies*, 4 EUR. COMP. J. 201, 203 (2008). In contrast, most vertical nonprice restraints, as well as maximum RPM, are presumptively lawful if undertaken by a supplier with a market share of less than 30%. *See id.* at 202. While an RPM agreement could be legal under EU law, Peeperkorn, the principal administrator of the European Commission's competition directorate, concludes that the "efficiency arguments mentioned in support of RPM are not very strong and that RPM is not an efficient instrument for bringing about these efficiencies." *Id.* at 212. As an alternative a strict *per se* rule, the EU approach is a sensible one.

[157] *See, e.g.,* II ABA SECTION OF ANTITRUST LAW, COMPETITION LAWS OUTSIDE THE UNITED STATES France-42, Germany-33, United Kingdom-56 (2001); *see also* Paldor, *supra,* at 51-52; SCHERER & ROSS, *supra*, at 549-50.

[158] A notable exception may be Canada, which recently decriminalized RPM and required the Competition Tribunal to find an adverse effect on competition before condemning it. *See* Budget Implementation Act (2009) (Can.) § 426, *available at* http://www2.parl.gc.ca/content/hoc/Bills/402/Government/C-10/C-10_1/C-10_1.PDF.

[159] *Leegin*, 127 S. Ct. at 2722.

[160] The Court, citing an *amicus* brief submitted by PING, Inc., a golf-club manufacturer, stated, "Even with the stringent standards in *Monsanto* and *Business Electronics*, this danger [of liability] can lead, and has led, rational manufacturers to take wasteful measures. A manufacturer might refuse to discuss its pricing policy with its distributors except through counsel knowledgeable of the subtle intricacies of the law. Or it might terminate longstanding distributors for minor violations without seeking an explanation.

the *Colgate* doctrine has been widely criticized as distorting the concept of "agreement" under Section 1, which not only sows confusion in the law, but results in immunizing all manner of vertical restraints without any analysis of actual competitive effects. Insofar as the expansion of the *Colgate* doctrine has been driven by the harshness of the *Dr. Miles* rule, as some commentators have suggested, then repealing *Dr. Miles* will permit courts to focus on economic substance rather than *Colgate*'s artificial and formalistic distinctions, or so the argument goes.[161]

This line of argument is unpersuasive. As an initial matter, the Court did nothing to modify the *Colgate* doctrine and as long as it remains good law it will continue to be invoked by defendants seeking immunity (rather than rule of reason treatment) from RPM (and other vertical restraints) claims and continue to bedevil conspiracy jurisprudence.[162] Indeed, as I noted at the outset, it appears that *Colgate* policies have proliferated since the *Leegin* decision. More significantly, however, the premise of this line of argument is that the justification for the *Colgate* doctrine is to "secure the procompetitive benefits associated with vertical price restraints through other methods."[163] This is revisionist history. While the bolstering of the *Colgate* doctrine in *Monsanto* may have been intended by the Court to achieve this result, the *Colgate* decision itself was based on "the long recognized right of trader or manufacturer engaged in an entirely private

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The increased costs these burdensome measures generate flow to consumers in the form of higher prices." *Id.* at 2722-23 (citations omitted).

[161] *See* ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE 372 (2d ed. 2008) (suggesting that "*Colgate*'s fiction of 'no agreement' . . . arguably would become unnecessary if minimum RPM were also to be judged under the rule of reason").

[162] *See Leegin*, 127 S. Ct. at 2734-35 (Breyer J., dissenting) ("No one has shown how moving from the *Dr. Miles* regime to 'rule of reason' analysis would make the legal regime governing minimum resale price maintenance more 'administrable,' . . . particularly since *Colgate* would remain good law with respect to *unreasonable* price maintenance.").

[163] *Leegin*, 127 S. Ct. at 2722; *see also id.* ("If we were to decide the procompetitive effects of resale price maintenance were insufficient to overrule *Dr. Miles*, then cases such as *Colgate* and *GTE Sylvania* themselves would be called into question."); *id.* at 2721 ("Only eight years after *Dr. Miles*, . . . the Court *reined in* the decision by holding that a manufacturer can announce suggested resale prices and refuse to deal with distributors who do not follow them.") (emphasis added).

business, freely to exercise his own independent discretion as to parties with whom he will deal."[164] In other words, *Colgate* was viewed as an exception to *Dr. Miles* that was "tolerated" by the need to protect a certain degree of manufacturer freedom.[165] The tension between *Colgate* and *Dr. Miles* existed for nearly as long as *Dr. Miles* itself and cannot count as an *independent* justification for overturning *Dr. Miles* any more than for overturning *Colgate*. On the contrary, the case for the latter is stronger, even for those on the fence about *Dr. Miles*.[166] Whether the standard for judging RPM agreements is the rule of reason or some form of *per se* rule, Congress should abolish the *Colgate* exception for "unilateral" RPM programs enforced by threats of termination.[167]

Conclusion

In 1937, Congress embarked on an experiment legalizing fair trade at the option of the states. It did not work and Congress repealed the experiment in 1975 in favor of a universal *per se* rule. Since then, discounting has become a way of life for Americans, eagerly pursued by some retailers, adamantly cursed by others, but diligently demanded by much of the consuming

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[164] United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[165] United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960); *see* Edward H. Levi, *The Parke, Davis-Colgate Doctrine: The Ban on Resale Price Maintenance*, 1960 SUP. CT. REV. 258, 325 ("*Colgate* is caught between the important right to refuse to deal and the antipathy to price fixing"); Leary & Mintzer, *supra*, at 308-09 (*Colgate* and its artificial distinctions are based on "a strong view that people should not be forced to continue business relationships against their will"). The irony of the Court rejecting out of hand the restraints on alienation or "dealer freedom" rationale for *Dr. Miles*, while relying on *Colgate* to overturn it, was apparently lost on the Court. *Cf.* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 67-69 (1977) (White, J., dissenting) (noting that both *Dr. Miles* and *Colgate* reflect concern for the autonomy of independent businessmen).

[166] The academic critique of the *Colgate* doctrine has been far more severe and universal than the criticism of *Dr. Miles*. *See* SULLIVAN & GRIMES, *supra*, § 7.2c, at 382 n.50 (citing sources).

[167] Notably, foreign jurisdictions do not allow manufacturers to obtain compliance with minimum resale prices by using threatened refusals to deal. *See* OECD RPM REPORT, *supra*, at 28 ("Most if not all other jurisdictions … have no exception like the *Colgate* doctrine."). For example, the Europe Union prohibits RPM obtained through "indirect means," including "linking the prescribed resale prices to . . . threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations . . . ." Guidelines on Vertical Restraints ¶ 47, 2000 O.J. (C 291) 1, 11 (European Commission).

public. The activist Supreme Court has decided that the *per se* rule is bad policy and would have the country try a new experiment with legalized fair trade "sometimes."

The *Leegin* decision is bad law and should be overturned legislatively for the reasons I have articulated above, including: 1) it flouts the intent of Congress; 2) there is no evidence that the *per se* rule did any harm or that overturning it will do consumers any good; 3) conversely, there is every reason to believe that the rule of reason will lead to higher prices, as the incidence of anticompetitive RPM increases, and to increased business uncertainty; 4) and treating RPM more harshly than nonprice restraints, as most countries do, makes sense.

As Justice Breyer concluded, "The only safe predictions to make about today's decision are that it will likely raise the price of goods at retail and that it will create considerable legal turbulence as lower courts seek to develop workable principles."[168] Congress has the prerogative to reject this experiment and AAI urges it do so.

[168] 127 S. Ct. at 2737.