Senate Judiciary Committee
Subcommittee on Antitrust, Competition Policy and Consumer Rights
"The Leegin Decision: The End of the Consumer Discounts
or Good Antitrust Policy?"
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Chairman Kohl, Members of the Antitrust Subcommittee,

Thank you for this opportunity to present the views of the American Antitrust Institute ("AAI") as you consider Congress's response to the Supreme Court's *Leegin*[1] decision, which overturned the venerable *Dr. Miles*[2] case and the *per se* rule against resale price maintenance ("RPM"). AAI, an independent non-profit education, research and advocacy organization,[3] submitted an *amicus curiae* brief to the Supreme Court urging the Court to uphold the *per se* rule, and we urge this committee to take action to restore some version of the rule.

This testimony is organized as follows: First, a brief introduction to AAI's position is provided. Second, I shall explain why the issue of the *per se* rule is important as a practical matter. Third, the testimony discusses the reasons that the Court's decision was wrongheaded both as a matter of 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 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

[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. The individual views of members of the Advisory Board or the Board of Directors may differ from the positions taken by AAI. This testimony was approved by the Board of Directors.

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, and the loss of uniform treatment among the States.

Introduction

AAI believes that the *Leegin* decision was wrongheaded 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. As Justice Breyer explained:

> 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.[4]

But before exploring in detail the reasons that *Leegin* was wrongly decided, let me explain why the issue is important as a practical matter. It has been suggested that the *Dr. Miles* rule really doesn't matter because manufacturers that wish to adopt RPM can do so indirectly by adopting so-called "*Colgate* policies" whereby manufacturers can lawfully coerce compliance with suggested retail prices by threatening to cut off noncompliant

[4] 127 S. Ct. at 2736.

retailers. Or manufacturers can restrict discounting by adopting certain types of minimum advertised pricing (MAP) policies, which prevent retailers from advertising below a minimum price. However, many manufacturers that consider *Colgate* policies at the behest of complaining retailers have been reluctant to adopt them because of their legal risks[5] and business consequences; manufacturers generally don't like to cut off "noncompliant" discounters. Indeed, one of the underappreciated benefits of the *per se* rule is the weapon it provides manufacturers to resist pressure from powerful retailers to restrict discounting.[6] And minimum advertised price policies allow for significant "leakage" in discounting.[7] In short, in the real world, we believe the *per se* rule still had a significant effect in protecting discounting in the economy.

To be sure, *Leegin* is not going to mean "the end of consumer discounts." 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 significant dollar amounts in today's retail marketplace of more than $3 trillion.[8] Moreover, increasing retail concentration and buyer power suggests that the risk of anticompetitive, retailer-induced RPM has increased since the fair trade era. Of course, the Supreme Court did not legalize RPM agreements; it subjected them to the rule of reason. And the

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[5] In addition to antitrust risks, manufacturers can face other claims from terminated distributors including those arising under state dealer-protection laws.

[6] *See* 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1632b, at 319 (2d ed. 2004) ("There is little doubt that *per se* illegality strengthens the hands of manufacturers in resisting dealer demands for price protection.").

[7] Indeed, where minimum advertised pricing policies are tantamount to RPM, the FTC had said it would consider them to be *per se* illegal. *See* In re Time Warner, Inc., 2000 FTC LEXIS 40 (2000).

[8] 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, then retail bills would increase by an average of roughly $750 to $1000 for a family of four. 127 S. Ct. at 2736.

Court said that in applying the rule of reason, "courts would have to be diligent in eliminating their anticompetitive uses from the market."[9] However, like Justice Breyer, we are skeptical that courts are likely to, or are capable of, rooting out anticompetitive RPM from the market on a case-by-case basis, particularly when there is no consensus on what constitutes anticompetitive RPM. And given the high cost of bringing a successful rule of reason case, as well as the history of the lower courts' rule of reason analysis of nonprice vertical restraints, it is inevitable that *Leegin* will mean an increased incidence of anticompetitive RPM and higher prices for consumers.

***Leegin* is Bad Jurisprudence**

Thirty two years ago, this Committee held seven days of hearings on S. 408, the bill that was enacted as the Consumer Goods Pricing Act of 1975.[10] 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.[11] This Committee, headed by Senator Hart, heard testimony from over 23 witnesses, including the head of the Antitrust Division, Thomas Kauper, and the chairman of the Federal Trade Commission, Lewis Engman, both of whom testified in favor of restoring the *per se* rule of *Dr. Miles.*[12] The House Judiciary Committee also held two days of hearings with seven witnesses, including the Deputy

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[9] 127 S. Ct. at 2719.
[10] Pub. L. No. 94-175, 89 Stat. 801 (1975).
[11] The Miller Tydings Act and the Consumer Goods Pricing Act of 1975 are the only two substantive amendments to Section 1 of the Sherman Act in its 117-year history. The McGuire Act amended the FTC Act.
[12] *See* Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess. 170-172 (1975) ("Senate Hearings") (Engman testifying that "fair trade laws are little more than anticompetitive price fixing, unadorned with any redeeming features"); *id.* at 172-177 (Kauper making strong case against "resale price fixing" in any circumstances).

Assistant Attorney General for Antitrust, who testified to the same effect.[13] The committee reports show that Congress believed that RPM was pernicious and should be banned.[14] The Committees heard the 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.[15]

Congress passed the Consumer Goods Pricing Act with overwhelming, bipartisan support, and President Ford enthusiastically signed it into law.[16] 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.[17] After the Reagan

[13] Fair Trade: Hearings on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 94th Cong., 1st Sess. 121-124 (1975) ("House Hearings") (testimony of Keith Clearwaters, Deputy Ass't Attorney General) (fair trade laws "legalize a certain type of price fixing").

[14] S. Rep. No. 466, 94th Cong., 1st Sess. 1 (1975) ("Senate Rep.") ("The purpose of the proposed legislation is to repeal Federal antitrust exemptions which permit States to enact fair trade laws [which are] legalized price-fixing. . . Without these exemptions the agreements they authorize would violate the antitrust laws."); *id.* at 2 (repeal "will prohibit manufacturers from enforcing resale prices."); H.R. Rep. No. 341, 94th Cong., 1st Sess. 2 (1975) ("House Rep.") ("An agreement between a manufacturer and a retailer that the retailer will not resell the manufactured product below a specified price is ... *per se* illegal under section 1 of the Sherman Act").

[15] The report of this committee rejected the dealer services case for RPM as follows: "Opponents were primarily service-oriented manufacturers who claimed retailers would not give adequate service unless they were guaranteed a good margin of profit. However, the manufacturer could solve this 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." Senate Rep., *supra*, at 3; *see also* House Rep., *supra*, at 4 ("[T]o the extent that … the retailer charges a higher price because he is providing more services to his customers, consumers should have the freedom to choose between paying more for those services and buying nothing but the unadorned product at a lower price from a competitor."); *id.* at 5 (rejecting "new product" exemption); *see also* House Hearings, *supra*, at 32 (quoting Bork's free-rider explanation for RPM).

[16] 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").

[17] *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.").

Administration's Justice Department sought to overturn the *per se* rule in *Monsanto*,[18] Congress passed appropriations measures in 1983, 1985, 1986, and 1987 preventing the Department from using appropriated funds for this purpose.[19] Such measures were no longer needed when the (first) Bush Administration came to office and promised to enforce *Dr. Miles*.[20] Between 1990 and 2000, the FTC and Department of Justice brought about 14 RPM cases; the States also brought numerous cases.

There matters stood until the Roberts Court granted certiorari in *Leegin* to reconsider the *Dr. Miles* rule. It is worth noting 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."[21]

What did the Court have to say about the legislative history of 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,

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[18] *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).

[19] *See* H.R. Rep. No. 237, 102nd 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')."

[20] *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").

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

> including the principle that our antitrust doctrines "evolve with new circumstances and new wisdom." [citations omitted][22]

With all due respect, we believe, like the dissent,[23] 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 a federal agency, it is staffed with law clerks rather than antitrust experts, has no ability independently to gather data, and is not subject to oversight by Congress. Just as Congress had to enact the Clayton Act in 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*,[24] it is necessary for Congress once again to rein in the Court and reestablish its primacy in making national competition policy.[25]

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,

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[22] 127 S. Ct. at 2724 (emphasis added).

[23] *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.").

[24] *See* Richard A. Posner, *Antitrust Law* 122 (2d ed. 2001).

[25] Academic criticism of the Court's unbridled antitrust law making is growing. *See, e.g.,* Andrew S. Oldham, *Sherman's March (in)to the Sea*, 74 Tenn. L. Rev. 319 (2007); Daniel A. Farber & Brett H. McDonnell, *"Is There a Text in this Class?" The Conflict Between Textualism and Antitrust*, 14 J. Contemp. Leg. Issues 619 (2005).

"[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.'"[26] However, while that standard has been asserted in some cases,[27] it is the wrong test. 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. The critical questions are always ones of frequency and magnitude relative to the business and legal alternatives."[28]

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 harms 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

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[26] 127 U.S. at 2717, *quoting* Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988).

[27] *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.").

[28] 8 Areeda & Hovenkamp, *supra*, ¶1628b, at 292. *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").

are more costly or less effective is nonexistent.

The Anticompetitive Effects of RPM

Both the majority and dissent in *Leegin* recognized that resale price maintenance poses "economic dangers."[29] What are those dangers?

Higher prices for one. The function of RPM is to raise resale prices to consumers and there is no dispute that RPM generally has that effect.[30] This would seem enough to make it competitively suspect,[31] and was the main reason Congress repealed the fair trade laws.[32] Studies of the fair trade era show that prices of items subjected to fair trade in fair trade states were significantly higher than in states where RPM was illegal, and that fair trade cost consumers *billions* of dollars a year.[33] 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.[34]

The Court was not impressed with the argument that RPM raises prices to consumers, "in the absence of a further showing of anticompetitive conduct."[35] The Court suggested that since the high prices may be accompanied by more dealer services,

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[29] 127 S. Ct. at 2719; *id.* at 2727 ("agreements setting minimum resale prices may have serious anticompetitive consequences") (Breyer, J., dissenting).

[30] *See* 8 Areeda & Hovenkamp, *supra*, ¶1604b, at 40 (RPM "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 (citing Overstreet that "price surveys indicate that resale price maintenance in most cases increased the prices of products sold").

[31] *See* National Soc'y of Professional 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).

[32] The 1975 Act itself is entitled, "An Act To amend the Sherman Antitrust Act to provide lower prices for consumers."

[33] *See* House Rep., *supra*, at 3; *see also* F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy"*, 1 Comp. Policy Int'l, Autumn 2005, 65, 72-74 (reviewing studies showing substantial consumer savings from termination of RPM in light bulb, retail drug, blue jeans, and other sectors).

[34] *See* F.T.C., Record Companies Settle FTC Charges of Restraining Competition in CD Music Market, May 10, 2000, at http://www.ftc.gov/opa/2000/05/cdpres.htm.

[35] 127 S. Ct. at 2718.

it is not *necessarily* the case that RPM reduces consumer welfare. The logic is unassailable but, as the discussion of the free-rider theory below demonstrates, there is no reason to believe that RPM, when legal, was generally used in order to provide more services, nor did the Court suggest that is the case.[36]

In addition to raising prices, RPM has a tendency to reduce innovation and efficiency in retailing. As Justice Breyer noted, RPM 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. . . ."[37] Even 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."[38] But while the majority was referring to RPM that is used to organize a retailer cartel, the effect is inherent in RPM regardless of the purpose for which it is employed.

The Court suggested that we must look beyond higher retail prices because 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.'"[39] However, any alignment of manufacturer and consumer interests evaporates if the manufacturer adopts RPM at the

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[36] At most, the Court said, the limited empirical evidence "does not suggest efficient uses of the agreements are infrequent or hypothetical." 127 S. Ct. at 2717.

[37] *Id.*; *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.").

[38] 127 S. Ct. at 2717.

[39] *Id.* at 2719, *quoting* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Ind. Org. 57, 67 (1998).

behest of its retailers.[40] As the Court noted, "If there is evidence that retailers were the impetus for a vertical restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer."[41] The Court acknowledged that the risk of RPM being used to facilitate dealer collusion is a "legitimate concern."[42] Moreover, the Court recognized that a "manufacturer might consider that it has little choice but to accommodate the retailer's demands for vertical price restraints if the manufacturer believes it needs access to the retailer's distribution network."[43] But while recognizing the retailer power explanation for RPM, the Court seemed oblivious to the changes in the economy that have heightened the risk of retailer-induced RPM. For example, the Court emphasized that a single retailer cannot "abuse" RPM without "market power," and quoted the old saw from *Business Electronics* that "retail market power is rare, because of the usual presence of interbrand competition and other dealers."[44] However, common sense says otherwise. Retail buyer power is common[45]

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[40] *See* Toys "R" Us, Inc. v. F.T.C., 221 F.3d 928, 938 (7th Cir. 2000) ("the 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).

[41] *Id.*, *citing* Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* 7-8 ("[T]here 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 . . . ."). The Court apparently did not accept the claim by the Solicitor General that that "RPM generally emanates from the manufacturer." Brief for the United States as Amicus Curiae Supporting Petitioner at 18. That assertion is belied by the historical record. As Professors Areeda and Hovenkamp conclude, "the Court's perception [in *Dr. Miles*] that dealer power may be the predominant explanation for much resale price maintenance may have been accurate." 8 Areeda & Hovenkamp, *supra*, ¶1620c4, at 217; *see also id.* ¶1604a, at 35 ("[M]anufacturers have often restrained intrabrand competition – especially through resale price maintenance – not to achieve more effective distribution but rather to appease dealer interests in excess profits or the quiet life.").

[42] 127 S. Ct. at 2717.

[43] *Id.*

[44] 127 S. Ct. at 2720.

[45] *See* 8 Areeda & Hovenkamp, *supra*, ¶1604d3, at 48, 49 ("Multibrand dealers' ability to substitute other brands gives the dealers considerable leverage."); William S. Comanor, *The Two Economics of Vertical Restraints*, 21 Sw. U. L. Rev. 1265, 1276-1281 (1992) (monopsony power arises from pervasive economies of scope in distribution sector); John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should* Brooke Group *Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?*, 72 Antitrust L.J. 625, 638-644 (2005) (buyer power can exist even when buyer does not have dominant market

and is increasing along with retail concentration.[46] 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."[47]

The Court also conceded the danger that RPM might be used to facilitate a manufacturer cartel,[48] but failed to recognize that RPM may also facilitate oligopolistic pricing that is not itself illegal.[49] Moreover, the Court did not acknowledge Justice Breyer's point 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."[50] Further, the Court failed to recognize manufacturers' incentive independently to adopt RPM in order to protect their own wholesale margins. Retail discounting is often harmful to the manufacturer because it

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position); *e.g., Toys "R" Us*, 221 F.3d at 930 (large toy manufacturers acceded to demands of Toys "R" Us to restrict distribution to lower margin warehouse clubs because manufacturers felt they could not find other retailers to replace it, despite the fact that its national market share was only 20%).

[46] *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); Deloitte, *2007 Global Powers of Retailing*, Stores, Jan. 2007, at 2-G8 (combined sales of ten largest retailers worldwide has grown to nearly 30% of total retail sales of top 250 retailers); OECD, *Buying Power of Multiproduct Retailers* 7 (1999) ("last twenty years have seen momentous changes in retail distribution including significant increases in concentration").

[47] 127 S. Ct. at 2733.

[48] 127 S. Ct. at 2716. *See* Brief of *Amici Curiae* Economists in Support of Petitioner 13 (objection "had some traction historically"); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 22 (FTC Bureau of Economics Staff Report 1983) ("The economics literature contains several examples of possible collusion among manufacturers which may have been facilitated by RPM."). For a recent example, *see* Dept. of Justice, *Massachusetts Tampico Fiber Distributor Charged in Price Fixing Conspiracy*, Aug. 29, 1996 ("textbook example of a cartel among producers enhanced and strengthened by a resale price agreement").

[49] *See* 8 Areeda & Hovenkamp, *supra*, ¶1606d-f, at 86-92 (RPM reinforces manufacturer coordination, whether express or tacit, by reducing utility of wholesale price cuts and increasing visibility of prices; "danger is more than theoretical"). Justice Breyer recognized that facilitation of tacit collusion was the main risk at the producer level. *See* 127 S. Ct. at 2727.

[50] 127 S. Ct. at 2734.

puts pressure on the manufacturer to reduce its wholesale prices.[51] 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."[52] In sum, we agree with Justice Breyer's conclusion that "resale price maintenance can cause harms with some regularity . . . ."[53]

The Costs of the *Per Se* Rule

What are the costs of the *per se* rule? How much procompetitive conduct is deterred, and what is the magnitude of the harm? If there are less restrictive alternatives that are as effective and not more costly than RPM, then any costs of the *per se* rule are minimal. The Court concluded that, "although the empirical evidence on the topic limited, it does not suggest efficient uses of the agreements are infrequent or hypothetical" and thus "the rule would proscribe a significant amount of procompetitive conduct. . . ."[54] The dissent disagreed. Justice Breyer could "find no economic consensus" on the how often RPM will be beneficial in practice.[55]

The advocates of RPM focus primarily on the "free rider" theory, contending that RPM can benefit consumers because the higher prices may induce retailers to provide pre-sale services that promote interbrand competition and otherwise would not be

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[51] *See* 8 Areeda & Hovenkamp, *supra*, ¶1606c, at 85-86; Robert L. Steiner, *How Manufacturers Deal With the Price Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 Antitrust L. J. 407, 441-442 (1997) (RPM may be used to tame the exercise of countervailing retail power); David Gilo, *Retail Competition Percolating Through to Suppliers and the Use of Vertical Integration, Tying, and Vertical Restraints to Stop it*, 20 Yale J. Reg. 25 (2003) (explaining how RPM offsets manufacturer's incentive to offer selective price cuts to distributors); *e.g.*, In re Time Warner, Inc., 2000 FTC LEXIS 40 (2000) (music companies' restriction on resale prices designed to shore up wholesale prices).

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

[53] 127 S. Ct. at 2729.

[54] *Id.* at 2717-18.

[55] *Id.* at 2729.

provided. This rather tired economic theory (dating back to Telser in 1960) was well known to Congress in 1975 and the Court in *Sylvania*, but nonetheless was rejected as a basis for permitting RPM.[56] Professors Comanor and Scherer in their *amicus* brief to the Court maintained that "there is skepticism in the economic literature about how often [free riding] actually occurs."[57] And, 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."[58] Moreover, as Klein and Murphy have noted, the standard free-rider theory for RPM is "fundamentally flawed" because it is based on "the unrealistic assumption that the sole avenue of nonprice competition available to retailers is the supply of the particular services desired by the manufacturer."[59] Klein and Murphy have shown that, "[n]o 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."[60] The "quality certification" version of the free-rider theory is similarly flawed in that "free riders" subject to RPM may continue to "free ride" on prestigious retailers by using their higher margins to offer services or other

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[56] *See supra* note 15.

[57] Comanor & Scherer, *supra*, 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 ("for most products, low-service discounting dealers do not impair the viability of full-service dealers; both exist side by side").

[58] 127 S. Ct. at 2729.

[59] Benjamin Klein & Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. Law & Econ. 265, 266 (1988). Klein and Murphy were part of the *amici* economists supporting the reversal of *Dr. Miles*.

[60] *Id.*

inducements not desired by the manufacturer.[61] Furthermore, even if RPM is used to prevent free riding and increase output, while it may be profit-maximizing for the manufacturer, there is no *a priori* reason to believe that consumers as a whole benefit because most consumers may prefer the lower-priced product without the services.[62] As Justice Breyer noted, insofar as RPM agreements encourage dealers to compete on service instead of price, they threaten "wastefully to attract *too many* resources into that portion of the industry."[63]

The Court also maintained that RPM "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."[64] The Court was 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."[65] 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.[66] Putting aside the issue of why competition among retailers in the

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[61] *See* Edward Iacobucci, *The Case for Prohibiting Resale Price Maintenance*, 19 World Comp. L & Econ. Rev., Dec. 1995, at 80-82; *see also* 8 Areeda & Hovenkamp, *supra*, ¶1613g, 156-165 (quality certification theory is "relatively weak" largely because elite dealers' services are usually not brand specific and RPM in this context may well reflect dealer power).

[62] Comanor & Scherer, *supra*, at 4-5; *see also 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").

[63] 127 S. Ct. at 2727 (emphasis added).

[64] *Id.* at 2716.

[65] 8 Areeda & Hovenkamp, *supra,* ¶ 1614, 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 competition, to ensure that contract termination has sufficient value as a threat.").

[66] 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 of these specific investments").

absence of free-riding would not be sufficient to ensure adequate dealer services,[67] this theory suffers from at least three flaws. First, as with the 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.[68] Second, insofar as higher retailer margins induce multibrand retailers to undertake nonprice sales efforts to favor one brand over another, the result is generally *anticompetitive*, not procompetitive.[69] Third, if the goal is merely to increase the rents earned by dealers, then there are less restrictive alternatives, such as lump sum payments.[70] Finally, one wonders how many manufacturers in the real world look to provide supranormal profits to their distributors so that the threat of termination is meaningful.[71]

Empirical Evidence

What of the empirical evidence? The majority, noting that "empirical evidence

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[67] 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." 127 S. Ct. at 2733.

[68] *See* Ittai Paldor, *Rethinking RPM: Did the Courts Have it Right All Along?* 199-202 (Working Paper 2007), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=994750.

[69] *See* 8 Areeda & Hovenkamp, *supra*, ¶1614, at 165-171 (rejecting dealer "goodwill" as justification for RPM; 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).

[70] *See* Paldor, *supra,* at 204-208; Iacobucci, *supra*, at 88.

[71] The Court also cited facilitation of new entry by manufacturers as a procompetitive rationale for RPM. 127 S. Ct. at 2716. This rationale has been questioned by scholars. *See, e.g.,* Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited*, 80 Calif. L. Rev. 817 (1992) (maintaining that less restrictive alternatives are available for new entrants); 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"). In fact, it can be argued that eliminating the *per se* rule will make entry more difficult -- for new and more efficient *retailers*, because they will be deprived of one of the most common strategies of new entry: price cutting. In any event, this rationale, if convincing, could be accommodated by a limited exception to the *per se* rule, as Justice Breyer suggested. *See* 127 S. Ct. at 2731 (if making policy in the first instance "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).

on the topic is limited," cited two "recent" empirical studies of litigated cases.[72] The Court did not claim that these studies show that procompetitive uses of RPM are common or important, merely that they do "not suggest that efficient uses of the agreements are infrequent or hypothetical."[73] One by Pauline Ippolito, published in 1991, reviewed all reported RPM cases (public and private) between 1976 and 1982.[74] The other by Thomas Overstreet, issued by the FTC in 1983, reviewed the 68 RPM cases brought by the FTC and resolved between 1965 and 1982.[75] Ippolito concluded that the cases were generally not consistent with dealer or manufacturer cartel theories, 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 the allegations of horizontal collusion in a resale price maintenance case and the tacit form that such collusion may take."[76] Ippolito also concluded that the "special services," or free rider theory, "has the *potential* to explain a nontrivial portion of the private litigation sample" based on the fact that 50 percent of the 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."[77] This can be 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.

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[72] 127 S. Ct. at 2715, 2717.
[73] *Id.* at 2717.
[74] Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. Law & Econ. 263 (1991). Ippolito herself notes, "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." *Id.* at 293.
[75] Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC Bureau of Economics Staff Report 1983). The Overstreet study also reviewed prior literature.
[76] 127 S. Ct. at 2732, *citing* Herbert Hovenkamp, *Federal Antitrust Policy* §11.3c, at 464 & n.19 (3d ed. 2005) (similar criticism).
[77] Ippolito, *supra*, at 283 (categorizing as complex such products as printing, funeral insurance, and television sets) (emphasis added).

In his study, Overstreet concluded that "RPM was not likely motivated by collusive dealers who successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel" based on the fact that in 47 cases where the data were available, over 80 percent involved more than 200 dealers.[78] But some of the most well-documented instances of RPM in history, such as those involving retail druggists, involved dealer cartels in highly unconcentrated markets.[79] Overstreet did not look for indications of procompetitive explanations of RPM, 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."[80] Neither Ippolito nor Overstreet considered whether dealer pressure without collusion, which might be considerable if a strong retailer accounts for a significant portion of the supplier's sales, might have accounted for any of the instances of RPM. In sum, neither of these studies does much to fill "the dearth of empirical evidence" on the effects of RPM noted by Ippolito. But, as Overstreet has elsewhere noted, "the historical experience, or practice of RPM [is] largely a sorry record of abuses, in sharp contrast to the contention of RPM's missionaries."[81]

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[78] 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.").

[79] *See* Thomas R. Overstreet Jr. & Alan A. Fisher, *Resale Price Maintenance and Distribution Efficiency: Some Lessons from the Past*, 3 Contemp. Policy 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.").

[80] Overstreet, *supra*, at 66.

[81] Overstreet & Fisher, *supra*, at 45; *see also* Overstreet, *supra*, at 15 n.1 (explaining that "the literature contains numerous examples where analysts have attributed the existence of RPM to pressures from organized trade groups, rather than to manufacturers' attempts to deal with 'free-rider' problems," citing Palamountain, Bowman, Yamey, and Hollander); Herbert Hovenkamp, *Federal Antitrust Policy* 451 (3rd ed. 2005) ("[a] wealth of history shows that dealers have attempted to use RPM imposed by suppliers to facilitate horizontal dealer collusion.").

Less Restrictive Alternatives

Perhaps the main flaw in the majority's analysis is its failure to consider that any procompetitive effects of RPM can be achieved by less restrictive means that do not prevent efficient retailers from passing on their lower costs to consumers. *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."[82] The most obvious way to ensure desired retailer services is to pay retailers for performing those services, using promotional allowances or other marketing techniques.[83] There is no empirical evidence whatsoever that such techniques are more costly or less effective than RPM in obtaining dealer services, which is perhaps why the Court ignored the point.[84] To be sure, promotional allowances for services may ultimately also raise consumer prices to account for the cost of the services, but unlike RPM, 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 really a question of

[82] *Amici Curiae* Economists, *supra*, at 9.
[83] *See, e.g., Toys "R" Us*, 221 F.3d at 933, 938 (rejecting free-rider argument because services performed by retailer, such as advertising, warehousing and full-line stocking, were compensated by manufacturer).
[84] 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 services the retailer must perform and the level that the retailer 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." *Amici Curiae* Economists, *supra*, at 9 (emphasis added). However, no evidence was offered as to empirical relevance of these possibilities. Moreover, merely raising retailer margins through RPM -- without contractual service requirements -- is generally ineffective in curtailing free riding. *See supra*. It is not apparent why a retailer would choose to provide services that the manufacturer does not even ask for when other retailers are not also required to provide such services, unless the services themselves are profitable for a retailer, which means that RPM is not necessary in the first place.

what kind of currency a manufacturer can use to buy those retailer services."[85]

The Court missed this simple truth, as is evident in its critique of the argument that RPM 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.[86]

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

Different Rules for 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,"[87] notwithstanding that the Court in *Sylvania* had said "[t]here are … significant differences that could easily justify different treatment."[88] In fact, different

[85] *Leegin*, Transcript of Oral Argument 48 (Mar. 26, 2007) (Barbara Underwood).
[86] 127 S. Ct. at 2719.
[87] *Id.* at 2723.
[88] *GTE Sylvania*, 433 U.S. at 51 n. 18. 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. Justice White, of course, would

treatment is justified because, as Professors Areeda and Hovenkamp explain, "Nonprice restraints fulfill a wider range of potentially legitimate objectives and threaten fewer harms to competitive interests" than RPM.[89] The Court in *Sylvania* had noted that unlike nonprice vertical restraints, RPM "almost invariably" reduces interbrand competition.[90] Indeed, RPM *is* more likely than nonprice restraints to restrict interbrand competition at both the retailer and manufacturer levels. At the retailer level, only RPM restricts dealers from competing on price *against other brands*.[91] And RPM, unlike nonprice restraints, prevents more efficient retailers from passing on the benefits of that efficiency to consumers.[92] Furthermore, RPM stultifies competition among multibrand retailers, which are generally not susceptible to territorial or customer restraints.[93] As a general matter, "[t]he form of restraint most likely to reflect dealer power is resale price maintenance." [94] The Court in *Sylvania* also aptly distinguished price and nonprice vertical restraints on the ground that price restraints, unlike nonprice restrains, can facilitate a manufacturers' cartel.[95]

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have retained the *per se* rule for territorial restraints, but with an exception for firms with minimal market power. *See GTE Sylvania*, 433 U.S. at 65-66 (White, J., concurring).

[89] 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.").

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

[91] Even airtight territorial exclusives allow restricted dealers to fully compete in their territories against dealers of other brands, but RPM prevents dealers "from engaging resellers of other brands in price competition." 8 Areeda & Hovenkamp, *supra*, ¶1630b, at 303.

[92] *See* Arthur H. Travers, Jr. & Thomas D. Wright, *Restricted Channels of Distribution Under the Sherman Act*, 75 Harv. L. Rev. 795, 801 (1962) (noting 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 by Justice Brennan in White Motor Co. v. U.S., 372 U.S. 253, 268 n.7 (1963)).

[93] *See* 8 Areeda & Hovenkamp, *supra*, ¶1604g6, at 65.

[94] *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.").

[95] *GTE Sylvania*, 433 U.S. at 51 n.18; *see also Business Electronics*, 485 U.S. at 725-26 (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*, ¶1606, at 99 ("[M]ost nonprice restraints lack the characteristics that enable [RPM] to support price coordination among manufacturers.").

Besides doing less harm, nonprice vertical restraints are more likely than RPM to have procompetitive benefits. 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.[96] Moreover, to the extent that territorial or customer restraints entirely eliminate intrabrand competition, they are more likely than RPM to solve free-rider problems because a service-providing dealer under RPM may lose business to free-riding dealers that maintain the same prices but offer other inducements to customers.[97] In short, it makes perfect sense to apply a more stringent standard to RPM than to nonprice vertical restraints.

Problems With the *Colgate* Doctrine

The Court thought that confusion in the *Colgate* doctrine, which permits manufacturers "unilaterally" to impose RPM, militated in favor of repealing *Dr. Miles*. After all, if the effects of "unilateral" and concerted RPM are the same, 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. As an initial matter, the tension between *Dr. Miles* and *Colgate* has existed since *Colgate* was decided in 1918. The fact that manufacturers may coerce compliance with suggested resale prices by threatening to refuse to deal with discounters had never been thought to justify abandoning *Dr. Miles*, but rather was accepted as an exception justified by the need to

[96] See 8 Areeda & Hovenkamp, *supra*, ¶1647; *GTE Sylvania*, 433 U.S. at 55 n.23.
[97] *See* Sullivan & Grimes, *supra*, §6.3b, at 338; Paldor, *supra*, at 293.

protect a certain degree of manufacturer freedom.[98] Second, as Justice Breyer pointed out, "since *Colgate* would remain good law with respect to *unreasonable* price maintenance"[99] any complications arising from the *Colgate* doctrine will persist. Third, if there is confusion in the application of the *Colgate* doctrine, then the logical solution is to attack the problem directly by legislatively limiting *Colgate* rather than indirectly by modifying *Dr. Miles*. After all, the academic critique of the *Colgate* doctrine has been far more severe and universal than the criticism of *Dr. Miles*.[100]

<u>The Rest of the World</u>

Most antitrust authorities around the world generally ban minimum RPM and treat it more harshly than nonprice vertical restraints.[101] For example, the European Union, which recently liberalized its treatment of most nonprice restraints, continues to treat minimum RPM as a "hardcore" restraint, equivalent to *per se* illegal.[102] Member States, many of which led the U.S. in abolishing fair trade, follow suit.[103] Canada treats RPM as a criminal offense.[104] The rest of the advanced industrialized world recognizes

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[98] *See* U.S. v. Parke, Davis & Co., 362 U.S. 29, 44 (1960). It has also been suggested that insofar as the determination of "unilateral" conduct under *Colgate/Monsanto* focuses on whether the conduct is in the independent best interest of the manufacturer, then the doctrine screens out instances of RPM that are less likely to be anticompetitive. *See* Hovenkamp, *Federal Antitrust Policy*, *supra*, at 471.

[99] 127 S. Ct. at 2734-35.

[100] *See* Sullivan & Grimes, *supra*, §7.2c, at 382 n.50.

[101] *See* OECD, *Resale Price Maintenance* 10 (1998) ("OECD RPM Report") (reporting that "RPM is generally prohibited in almost all OECD countries, subject to a few exemptions, mostly for books, newspapers and medicaments."), at http://www.oecd.org/dataoecd/35/7/1920261.pdf.

[102] Commission Regulation (EC) No 2790/1999, 1999 O.J. (L336) 21. 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.*; Joseph F. Winterscheid & Margaret A. Ward, *Two Part Harmony: New Rules for Vertical Agreements Under European Union Competition Policy*, Antitrust, Summer 2000, at 52.

[103] *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 53-54; Scherer & Ross, *supra*, at 549-550.

[104] *See Record Canadian Fine is Levied in Resale Price Maintenance Case*, 83 Antitrust & Trade Reg. Rep. (BNA) 410 (Oct. 25, 2002).

the wisdom of the *Dr. Miles* rule.[105]

The Costs of the Rule of Reason

Although the Court said that the lower "courts would have to be diligent in eliminating … anticompetitive uses [of RPM] from the market," and instructed them to "establish the litigation structure to ensure that the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses,"[106] this will not be an easy exercise, as Justice Breyer pointed out. The Court suggested certain relevant considerations for the rule of reason, but in fact offered little guidance. The Court allowed that the "source of the restraint" may be an important consideration under the rule of reason, 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."[107] The Court also said that market power is important, but the absence of traditionally-defined market power[108] on the part of the

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[105] *See* OECD Report, *supra,* at 130 (EC official explaining anticompetitive effects of RPM and that "if one supposes that RPM can improve efficiency, this economic efficiency could be achieved by less costly means in terms of competition"). Moreover, both Europe and Canada do not allow manufacturers to obtain RPM indirectly, for example, by threatening to refuse to deal with retailers that price below suggested retail prices. *See* Commission Notice, Guidelines on Vertical Restraints, 2000 O.J. (C 291) 1 ¶47 (European Commission) (RPM through indirect means prohibited, including "linking the prescribed resale prices to ... threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations"); Competition Act, R.S.C. ch. C-34, §61(1) (Can.) ("No person who is engaged in the business of producing or selling a product ... shall, directly or indirectly, (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada").

[106] 127 S. Ct. at 2719, 2720.

[107] *Id.* at 2730.

[108] Market share is normally the indicator of market power, but manufacturers with relatively small market shares but powerful brands may have significant market power. S*ee* Sullivan & Grimes, *supra*, §7.3a1, at 384-388. Likewise, multibrand retailers with relatively modest market shares may have significant buyer power. *See, e.g., Toys "R" Us*, 221 F.3d 928. It is commonly understood by economists that neither retailers nor manufacturers will engage in RPM without some interbrand market power. *See* Ward 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 324-325 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products").

manufacturer or dealers does not mean that RPM is not anticompetitive. In any event, 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."[109] Also, the Court declined to offer any guidance on the nub of the controversy – identifying procompetitive uses of RPM – 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."[110]

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 Professor Pitofsky notes, "rule of reason cases often take years to litigate and are extremely expensive" and "it is very difficult for a plaintiff (either the government or a private party) to win a rule of reason case."[111] Indeed, most commentators agree that the *Sylvania* rule of reason, as applied by the lower courts, has resulted in a rule of *de facto per se* legality for nonprice vertical restraints.[112] Even if the lower courts are more diligent about RPM, the cost 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 RPM will go unremedied. Manufacturers that face pressure from

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[109] 127 S. Ct. at 2730.

[110] *Id.*

[111] Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1489 (1983).

[112] *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 has established for RPM, *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.

retailers to adopt RPM will no longer be able to just say "no, it's illegal."

Another cost of *Leegin* is the uncertainty for businesses that results from the fact that many states ban RPM, sometimes expressly,[113] and will not necessarily follow *Leegin* under their antitrust laws. This threatens to recreate the balkanized state of affairs that existed prior to the Consumer Goods Pricing Act of 1975, when fair trade was legal in some states and illegal in others. Indeed, given the anti-consumer effect of RPM, some states that follow the Sherman Act can be expected to adopt "*Leegin* repealers" (either by statute or judicial construction), perhaps replicating the confusion, uncertainty, and expense that has resulted from the divergent treatment of indirect purchaser damage actions under the Sherman Act and state law.[114]

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. 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 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) treating RPM more harshly than nonprice restraints, as most

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[113] *See, e.g.,* N.Y. Gen. Bus. L. § 369-a (2007).
[114] *See* Donald I. Baker, *Hitting the Potholes on the* Illinois Brick *Road*, Antitrust, Fall 2002, at 14.

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."[115] Congress has the prerogative to reject this experiment as too risky and AAI urges it do so.

[115] 127 S. Ct. at 2737.