The American Antitrust Institute

December 5, 2007

Deborah Platt Majoras
Chairman
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

Re: Petition of Nine West Footwear Corp. to Reopen and Modify Order, FTC File No. 981-0386.

Dear Chairman Majoras:

The American Antitrust Institute ("AAI") urges the Commission to deny the Petition to Reopen and Modify Order ("Pet.") filed by Nine West Footwear Corp. ("Nine West"), which would abrogate the Commission's consent order barring Nine West from fixing minimum resale prices on women's footwear products. *In re Nine West Group, Inc.*, FTC Dkt. No. C-3937, 2000 FTC LEXIS 48 (Decision and Order, April 11, 2000).[1]

Nine West has failed to make "a satisfactory showing that changed conditions of law or fact require the . . . order to be . . . set aside . . . or that the public interest so requires." 16 C.F.R. § 2.51(b); *see In re Johnson & Johnson*, FTC Dkt. No. C-4154, 2006 FTC LEXIS 30, at *6 ("A 'satisfactory showing' requires, with respect to public interest requests, that the requester make a prima facie showing of a legitimate public interest reason or reasons justifying relief."). Even assuming *arguendo* that the change in the law occasioned by the Supreme Court's recent decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* warrants reopening the proceeding, the petition to modify the consent order should be denied because Nine West has failed to establish that permitting it to engage in resale price maintenance would satisfy *Leegin*'s rule of reason standard or benefit consumers. *See In re Johnson & Johnson* at *7 ("In no instance does a decision to reopen an order oblige the Commission to modify it, and the burden remains on the requester in all cases to demonstrate why the order should be reopened and modified. The petitioner's burden is not a light one in view of the public interest in repose and the finality of Commission orders.").

If the Commission decides to reopen the consent order, AAI urges it to clarify how the rule of reason generally should be applied to minimum resale price maintenance ("RPM") agreements.[2] In particular, the Commission should adopt a framework based on

[1] Nine West's petition seeks "modification" of the order by deleting its only operative provisions, and hence is effectively a request to set aside the order.

[2] The Supreme Court in *Leegin* invited the lower courts to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to

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Polygram Holding that would: (1) place the initial burden of justifying an RPM agreement on the manufacturer or, in the alternative, find a prima facie case for illegality where, as here, RPM may be widespread in the industry and the manufacturer is also a significant retailer; (2) clarify that a free-rider defense requires more than conclusory factual assertions of the type asserted in Nine West's petition; and (3) reject the supposed effect of discounting on "brand image" as a cognizable justification for RPM.

Background

Petitioner Nine West is a wholly-owned subsidiary of Jones Apparel Group, Inc. ("Jones"), a leading designer, marketer, and wholesaler of branded apparel, footwear and accessories. Jones Apparel Group, Inc., Form 10-K, Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended Dec. 31, 2006, at 4. Jones, a Fortune 500 company, had sales in 2006 of approximately $4.7 billion, of which nearly $1 billion came from wholesale footwear sales.[3] *Id.* at 36. Jones also owns and operates more than 400 specialty retail stores and 700 outlet stores that sell Nine West and its other brands of footwear and/or apparel. *Id.* at 7, 8.

Nine West asserts three grounds for permitting it to engage in resale price maintenance. It contends that RPM would be procompetitive because it curtails free riding and protects its brand image. Pet. 9-10. It suggests that RPM would not be anticompetitive because it is unlikely to facilitate collusion given the "highly competitive conditions in the women's footwear market today . . . ." *Id.* at 10. And it argues that lifting the RPM ban would be fair because its competitors can and are engaging in RPM. *Id.* at 11; *see* Declaration in Support of Petition to Reopen and Modify Order ("Cohen Decl.") ¶ 15. None of these arguments is sufficient alone, or collectively, to conclude that allowing Nine West to engage in RPM would benefit consumers or satisfy the rule of reason.

Anticompetitive Effects

Parties engaged in resale price maintenance should have the initial burden of justifying it because RPM "falls within the category of restraints that are likely, absent countervailing procompetitive justifications, to have anticompetitive effects – i.e., lead to higher prices or reduced output." *In re Polygram Holding, Inc.*, FTC Dkt. No. 9298,

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provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones." *Leegin*, 127 S. Ct. 2705, 2720 (2007). The Commission, as the expert antitrust agency, is well positioned to provide guidance to the courts for adjudicating RPM claims.

[3] It is not clear how much of Jones's footwear sales are subject to the consent order, *see* Decision and Order ¶ I(C) (defining "Nine West Products"), but Nine West itself suggests that its annual sales to department stores alone presently are in the range of $450 million. *See* Declaration in Support of Petition to Reopen and Modify Order ¶ 8.

2003 FTC LEXIS 120, at *72 (2003), *aff'd*, *Polygram Holding, Inc. v. Fed. Trade Comm'n*, 416 F.3d 29 (D.C. Cir. 2005). Treating resale price maintenance as "inherently suspect" is consistent with the economic learning cited in *Leegin*, as well as common sense, because resale price maintenance generally raises prices paid by consumers.[4] To be sure, the Court rejected the price-elevating effect of RPM as an argument for retaining the *per se* rule[5] because higher prices may be accompanied by additional services that consumers value.[6] However, that does not mean it is inappropriate to place the initial burden on the manufacturer to demonstrate a procompetitive rationale for barring discounting on the products it sells. In the absence of other evidence, eliminating discounting may be presumed to harm consumers, and the manufacturer is in the best position to provide that evidence, if it exists.

In this case, the increase in prices was not merely theoretical. The complaint alleged that "[p]rices to consumers of Nine West products have been increased, or have been prevented from falling," Complaint ¶ 8a, and Nine West agreed to pay $34 million in overcharges in a settlement with the Attorneys General for 56 U.S. states, territories, commonwealths and possessions. *See* Press Release, Nine West Settles State and Federal Price Fixing Charges (March 6, 2006), http://www.ftc.gov/opa/2000/03/ninewest.shtm.

In any event, two factors present here are sufficient to make out a *prima facie* case of anticompetitive effect. First, it appears that resale price maintenance is widespread in the women's footwear market. According to Nine West,

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[4] *See Leegin Creative Leather Products, Inc. v. PSKS, Inc.,* 127 S. Ct. 2705, 2718 (2007) ("'price surveys indicate that [resale price maintenance] in most cases increased the prices of products sold'") (quoting Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 160 (FTC Bureau of Economics Staff Report 1983)) (alteration in original); *id.* at 2727 (RPM "prevent[s] dealers from offering customers the lower prices that many consumers prefer") (Breyer, J., dissenting); *see also* 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1604b, at 40 (2d ed. 2004) (resale price maintenance "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point.").

[5] *See Leegin*, 127 S. Ct. at 2718 ("Respondent is mistaken in relying on pricing effects absent a further showing of anticompetitive conduct.").

[6] *See id.* (higher prices "'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, *supra*, at 106) (emphasis added; alteration in original). The Court also suggested that if additional services increase demand for the manufacturer's product, then interbrand competition is fostered "from which lower prices can later result." *Id. But see* Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* 331 (2d ed. 2006) (noting that distribution restraint may promote brand differentiation, [b]ut "interbrand competition recedes as brands become more differentiated – consumer demand for a particular maker's product becomes less elastic").

> [M]any of Nine West's competitors use some type of resale price maintenance program -- either "off limits" (no discounting) lists, "break date" lists (discounting permitted only during specified sales events or other specified periods) or refusal to accept returns if suggested retail prices or break dates are not followed. In addition, many competitive brands are excluded from department store point-of-sale coupons. In some cases the exclusion is required by the vendor . . . .[7]

The Supreme Court in *Leegin* recognized that "the number of manufacturers that make use of the practice in a given industry can provide important instruction," and that "[r]esale price maintenance should be subject to more careful scrutiny . . . if many competing manufacturers adopt the practice." *Leegin*, 127 S. Ct. at 2719. Widespread coverage of resale price maintenance is problematic not only because it facilitates horizontal coordination among manufacturers or retailers, but also because it "'deprive[s] consumers of a meaningful choice between high-service and low-price outlets . . . .'" *Id.* at 2719 (quoting F.M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 558 (3rd ed. 1990)); *see also* 8 Areeda & Hovenkamp, *supra*, ¶ 1633c, at 331 ("Resale price maintenance can be dangerous when it covers a large portion of the retail market. In that event, the restraint reduces interbrand competition. Dealers therefore have an incentive to seek the vertical restraint, and consumers are left with few unrestrained alternatives. Where multibrand dealers are typical, moreover, widespread coverage within the manufacturers' market may also mean that the manufacturers use the restraint to induce dealer recommendations that deceive consumers.").[8]

Nine West contends that "highly competitive conditions in the women's footwear market today make it unlikely that minimum resale price restraints could be used to facilitate collusion." Pet. 10. However, Nine West offers no supporting data about concentration in the women's footwear market,[9] and the use of RPM by "many of [its]

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[7] Cohen Decl. ¶ 15.

[8] While Areeda and Hovenkamp would define "widespread coverage" at 50% of a *retail* market, they note that the definition of widespread coverage is arbitrary, 8 Areeda & Hovenkamp, *supra*, ¶ 1632f , at 328, and that the danger of RPM being used to facilitate manufacturer coordination in a concentrated market "does not disappear" at market coverage between 10-50 percent. *Id.* ¶ 1606g5, at 96. Any assessment of the extent of coverage should include not only express resale price agreements but also sales made by vertically integrated firms and "informal" RPM, such as that obtained when manufacturers offer inducements to retailers to maintain specified prices or have announced "Colgate policies" to withhold supplies from discounters. *See id.* ¶ 1606g6, at 96 ("In measuring market coverage, vertically integrated firms should be counted among those using the vertical restraint, along with firms controlling resale prices informally.").

[9] Nine West contends that "[t]he women's footwear market is highly competitive, and there are not significant barriers to entry." Cohen Decl. ¶ 9. In support of this proposition, it asserts that

competitors" tends to undermine its assertion. In any event, the risk of collusion (or coordinated interaction) is not the only problem with widespread market coverage. As noted above, parallel use of vertical price restraints inevitably lessens interbrand competition, deprives consumers of meaningful choice, and may produce output reductions in the entire product category.

The second factor supporting a *prima facie* case is that Nine West is a significant retailer as well as a wholesaler.[10] Dual distribution increases the likelihood that RPM is imposed to protect downstream profits of retailers rather than promote distributional efficiencies. *See* Robert Pitofksy, *Are Retailers Who Offer Discounts Really "Knaves"?: The Coming Challenge to the* Dr. Miles *Rule*, Antitrust, Spring 2007, at 61, 62 (noting anticompetitive effect of RPM where manufacturer is also a substantial retailer).[11]

Procompetitive Justifications

To justify resale price maintenance agreements, proponents should be required to show that resale price maintenance is reasonably necessary to achieve a legitimate business purpose that benefits consumers. *Cf. Polygram Holding*, 416 F.3d at 36 (to rebut presumption of illegality "defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm").[12] "To prove a legitimate purpose, the manufacturer must offer proof that it has such a purpose and that the restraint serves it." 8 Areeda & Hovenkamp, *supra,* ¶ 1633d2, at 335. In addition, the Commission should require substantial evidence that "less restrictive alternatives would be significantly more costly

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"Nine West brands relevant to this application compete with approximately 200 other women's footwear brands," that "[t]he number of national women's footwear brands that compete with Nine West and that are sold in department stores increased by over 40% between 2003 and 2006," and that Nine West has a 12.5% market share in the market for department stores sales. *Id.* ¶¶ 8, 9.

[10] *See id.* ¶ 6 (Nine West's "footwear is also marketed and sold directly to consumers through specialty and outlet retail stores owned and operated by an affiliate of Nine West."). Nine West's parent, Jones, derives about 17% of its revenue from its retail stores selling Nine West and other brands. *See* Jones Apparel Group Third Quarter 2007 Earnings Presentation 4, 5 (Oct. 31, 2007), *available at* http://phx.corporate-ir.net/phoenix.zhtml?p=irol-eventDetails&c=85851&eventID =1671985.

[11] Areeda and Hovenkamp maintain that dual distribution is likely to make the manufacturer more resistant to anticompetitive exercises of dealer power because its self-distribution can act as a competitive check on dealers. *See* 8 Areeda & Hovenkamp, *supra*, ¶ 1605c2, at 73. But this very threat may lead retailers to insist on RPM – as protection from discounting by company-owned stores.

[12] Consistent with *Polygram Holding*, proponents might alternatively show that RPM is not likely to harm consumers because its effect on commerce is *de minimis*. Nine West does not make such an argument here.

or significantly less effective." *Id.* at 337. If the proponents establish a legitimate business purpose that benefits consumers, the RPM agreement may still be unlawful if its anticompetive effects predominate. *See id.* ¶ 1633e3(B), at 338 ("With respect to dangers other than dealer power, legitimate functions for the restraint do not dispel the danger; they only weigh against it . . . ."); *cf. Polygram Holding*, 416 F.3d at 36 (defendant's justification may be rebutted with sufficient evidence "to show that anticompetitive effects are in fact likely").

Free riding. While *Leegin* recognizes that preventing free riding is a legitimate procompetitive use of RPM, the mere assertion of "free riding" can hardly be sufficient to establish this defense. *See* 8 Areeda & Hovenkamp, *supra*, ¶ 1611f at 135 ("If the governing legal rule allows attention in a particular case to a possible service justification, the manufacturer must allege and produce some evidence that such services are substantially impaired by unfettered intrabrand competition. This requires evidence that the manufacturer's product is significantly differentiated from rival products and that dealers provide substantial point-of-sale services of the kind that can be impaired by free riding.").

Nine West's free-riding justification is factually deficient. The extent of Nine West's free-riding defense is contained in two paragraphs in the supporting declaration of Nine West's CEO, Andrew Cohen:

> To promote brand recognition and loyalty, Nine West relies upon its retailers to provide adequate and appropriate floor space, advertise and promote Nine West's branded products, actively manage product assortment and flow, and employ highly trained sales personnel, thereby bolstering consumer perception of Nine West brands.
>
> Assembling a highly qualified sales and merchandizing [sic] staff and promoting and dedicating floor space to particular brands require financial investments, which generally retailers make only if there is assurance of reasonable profit margins. Retailers are also reluctant to make such investments if other retailers will inevitably free ride on those efforts while selling the product at much lower prices.[13]

Nine West's contention fails to distinguish it from virtually every other supplier of retail goods who would argue against discounting. Nine West offers no evidence whatsoever that any discounting retailers are in fact free riding on the services provided by other retailers. Are consumers taking advantage of the services provided by certain

[13] Cohen Decl. ¶¶ 12, 13.

retailers and then buying from lower-priced retailers that do not offer the services? Have full-service retailers in fact reduced the services provided for Nine West products as a result of free riding? Or is free riding not a problem because Nine West compensates its retailers for the services they provide? As to the first two questions, no evidence is cited; as to the latter question, it appears that Nine West has adopted other means to ensure that its retailers provide high quality services. For example, Jones states in its 2006 annual report:

> We believe retail demand for our apparel products is enhanced by our ability to provide our retail accounts and consumers with knowledgeable sales support. In this regard, we have an established program to place retail sales specialists in many major department stores for many of our brands . . . . These individuals have been trained by us to support the sale of our products by educating other store personnel and consumers about our products and by coordinating our marketing activities with those of the stores. . . . In addition, we have a program of designated sales personnel in which a store agrees to designate certain sales personnel who will devote a substantial portion of their time to selling our products *in return for certain benefits.*[14]

The Commission should apply the same scrutiny to the free-rider justification asserted by Nine West that it did in *Toys "R" Us*, where the Commission found the free-rider defense to be severely flawed because, *inter alia*, Toys "R" Us was compensated by toy manufacturers for all significant services it provided and it presented "no evidence, beyond speculation, that the clubs' 'no-frills' approach did or would drive valuable services out of the market place -- an essential element of the 'free-rider defense.'" *In re Toys "R" Us, Inc.,* FTC Dkt. No. 9278, 1998 FTC LEXIS 185, at *2-3 (1998), *aff'd*, *Toys "R" Us, Inc. v. Fed. Trade Comm'n*, 221 F.3d 928, 938 (7th Cir. 2000) (noting that Commission had made "plausible argument for the proposition that there was little or no opportunity to 'free ride' on anything . . . . [T]he manufacturers were paying for the services TRU furnished, such as advertising, full-line product stocking, and extensive inventories."). Nine West's free-rider justification is similarly flawed.

Brand image. The second "procompetitive" justification offered by Nine West is that RPM is needed to protect its brand image. According to Nine West, "the sale of Nine West products by certain retailers at near-wholesale prices itself damages brand integrity by eroding the consumer perception that Nine West products are well-made, fashionable and in high demand." Pet. 9. Nine West's CEO explains:

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[14] Jones Apparel Group, Inc., Form 10-K, *supra*, at 13-14 (emphasis added).

> Consumers inherently associate higher-end women's footwear with a particular price range. When certain retailers constantly offer Nine West products at extremely low, near-wholesale prices, consumers may incorrectly conclude that Nine West products are lower quality or less desirable, which can result in harm to brand integrity and Nine West's competitive position generally.[15]

The Commission should categorically reject this type of brand-image argument as a cognizable justification for resale price maintenance. As Professor 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." 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).[16]

This theory rests on the generally implausible assumption that the demand for the good is upward sloping, even though particular retailers are able to increase output by lowering price. *See id.* ¶ 1613c, at 156 (postulated upward-sloping demand curve has little empirical support). 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), as Nine West suggests, 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." H.R. Rep. No. 94-341, at 5 (1975).[17]

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[15] Cohen Decl. ¶ 14.

[16] It is noteworthy that in *Leegin*, the manufacturer justified its RPM policy in part on the ground that "discounting harmed [its] brand image and reputation," *Leegin*, 127 S. Ct. at 2711, yet the Court did not allude to this theory as a potential procompetitive justification. *See id.* at 2715-16 (citing free rider, new entry, and contractual fidelity theories); *see also* Brief of Amici Curiae Economists in Support of Petitioner 5-11, *Leegin*, 2007 WL 173681 (offering only free rider, contractual fidelity, and demand uncertainty as procompetitive theories in the economics literature).

[17] Nine West does not rely on the argument that consumers value higher prices because of snob appeal, perhaps because its women's footwear brands are not at the high end of the price scale and are sold in company-owned outlet stores in addition to department stores such as Macy's. *See* Jones Apparel Group, Inc., Form 10-K, *supra*, at 7; Alex Kuczynski, *Seeking Retail Therapy In a Temple of Fashion*, N.Y. Times, April 6, 2006, at G1 (characterizing Nine West as a "rela-

Conclusion

Should the Commission conclude that it is appropriate to revisit the consent order because of the *Leegin* decision, it should deny the petition under a "quick look" rule of reason. RPM in general, and in this case in particular, is competitively suspect, and the procompetitive justifications offered by Nine West either lack any factual support (the free-rider theory) or are not cognizable (the brand-image justification).

Sincerely,

Richard M. Brunell
Director of Legal Advocacy

cc: Donald S. Clark, Secretary (by Federal Express)
Commisisoner Pamela Jones Harbour
Commissioner Jon Leibowitz
Commissioner William E. Kovacic
Commissioner J. Thomas Rosch
Jeffrey Schmidt, Director, Bureau of Competition
Ronald S. Rolfe, Cravath, Swaine & Moore

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tively frowzy brand[]"). Even if snob appeal, or conspicuous consumption, might support an upward-sloping demand curve in some circumstances, such a rationale should be rejected as a 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 setting the wholesale price or by restricting distribution to high-end retailers, without the anticompetitive side effects of RPM. *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."); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L. J. 1487, 1494 (1983); *e.g.,* Rachel Dodes, *Style & Substance: Slumping Nine West Tries On Designer Shoes*, Wall. St. J., March 31, 2006, at B1 (reporting that Nine West was introducing expensive limited-edition designer collections in limited number of outlets; executive stated, "'Part of the allure is having a very narrow distribution'").