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INTERNET RETAILING AND "FREE-RIDING": A POST-*LEEGIN* ANTITRUST ANALYSIS

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Resale price maintenance (RPM) is a vertical price restraint that prohibits retailers from selling products below certain manufacturer-specified prices. The practice was condemned as per se illegal in 1911 in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[1] In 2007, a sharply divided Supreme Court in *Leegin Creative Products, Inc. v. PSKS, Inc.*[2] overruled *Dr. Miles* and replaced per se illegality with a rule of reason analysis. In antitrust, the rule of reason has operated much like a de facto *legality* rule, particularly in vertical nonprice restraint cases[3] after *Continental T.V., Inc. v. GTE Sylvania, Inc.*[4] There is some indication that the rule may morph into de facto legality for RPM as well.[5]

Perhaps not surprisingly, there has been a post-*Leegin* resurgence of RPM programs prohibiting retailers' ability to price below set minimums.[6] If this trend continues, it can severely impact Internet retailing because the ability to charge relatively lower prices is one of the sector's competitive strengths. Two affected Internet retailers, BabyAge.com and Baby Club, have filed antitrust suit against Babies 'R' Us alleging that the powerful retail chain had coerced manufacturers of high-end baby products to institute RPM agreements in order to stop Internet discounting.[7]

The *Leegin* majority's decision to overrule *Dr. Miles* seemed heavily influenced by economics literature showing possible benefits for RPM.[8] The benefit most widely asserted is that RPM can control free rider problems and thereby encourage

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dealer services, promote competition among brands, and enhance consumer welfare. The literature, however, has mostly overlooked the increasing importance of Internet use and Internet retailing in the last decade, and how this might affect the arguments both for and against RPM.[9]

This article examines the characteristics of the Internet, Internet retailing, and the issues they raise pertaining to the free rider justification. It argues that the case for RPM as a means of controlling free riding problems is probably further weakened, not strengthened, by the advent of Internet retailers. No doubt, for the subset of products that consumers are reluctant to buy without first "experiencing" them, the ease of Internet searches and online shopping may increase the occurrence of free riding. For most other products, however, the abundance of information available online should *diminish* the need for in-store demonstrations or knowledgeable sales assistance and, thus, the frequency of free-riding. Several recent marketing studies seem to be consistent with this analysis,[10] and to further suggest that, contrary to conventional wisdom, free riding may be synergistic, not harmful.[11] These new insights call into question the usual free rider arguments in favor of RPM agreements.

Even if one rejects these insights and views free riding strictly from a conventional perspective, RPM is not particularly effective in eliciting from Internet retailers the types of brick-and-mortar services upon which they are allegedly prone to free ride. In any event, there are other less anticompetitive means of achieving the objective—means that would not prohibit retailers' ability to compete on price.

Given the many benefits of Internet retailing and the risk that prohibiting discounting would impede its growth, it would be unwise to allow the rule of reason to devolve into a de facto legality rule for RPM. This article suggests a way forward that would avoid this result and yet not run afoul of *Leegin*.

THE FREE RIDING NARRATIVE

The *Leegin* majority and most RPM supporters acknowledge that RPM has anticompetitive effects but assert that they are outweighed by its procompetitive uses.[12] The primary efficiency claim is that RPM enhances welfare by remedying free rider effects.[13] In a nutshell, the classic free rider theory posits that certain product-specific services that cannot be charged separately to consumers, such as product demonstrations and information from knowledgeable salespeople, may be essential for the effective marketing of a product.[14] But as long as consumers can obtain these services from one retailer but buy at a discount from another offering no such services, few retailers would be willing to provide the services, leading to an overall decrease in demand for the product. By prohibiting discounting, RPM is said to remedy the free rider problem and induce retailers to compete for sales by providing the desired product-specific services.

A variant of the classic free rider theory posits that a reputable retailer's stocking of an item certifies its quality or stylishness and that "quality certification" free riding occurs when discounters who did not invest to develop this reputation sell to customers who desire the product because it has the reputable retailer's stamp of approval.[15] And this is said to deter retailers from investing in quality certification or becoming reputable retailers.

The free rider debate in relation to RPM has usually focused on the actual significance of the justification and whether it is more theoretical than real.[16] While few have seriously disputed the theoretical validity of the hypothesis, there is considerable skepticism of the broad claim that RPM is usually instituted as an efficient response to free riding. In his *Leegin* dissent, for example, Justice Breyer asked rhetorically "how often the 'free riding' problem is serious enough to significantly deter dealer investment."[17] RPM opponents have long asserted that the classic free rider theory has little applicability because few products require product-specific retailer services for effective marketing and few retailers actually provide them.[18] Yet, history shows that RPM has been adopted for a wide variety of products including boxed candies, pet foods, jeans, vitamins, shampoo, men's underwear,[19] shoes,[20] and women's handbags (*Leegin*). The quality certification free rider explanation, likewise, is somewhat questionable. Most instances of RPM seem to involve established brands, which do not particularly need a prestige retailer's certification. There is also no evidence of an *underprovision* of

luxury or quality goods, or of reputable or upscale stores, in our economy.

Even for complex products for which special retailer services may play a role in encouraging sales, the significance of the free rider problem is dubious. After all, as Breyer noted in his *Leegin* dissent, despite *Dr. Miles*'s longstanding per se prohibitions against RPM, we have had no shortage of producers supplying, and retailers selling, "complex technical equipment (as well as expensive perfume and alligator billfolds) to consumers."[21] Thus, the standard claim that the need to control free riding problems explains most RPM agreements seems overstated and unconvincing.

An issue that has not been much explored to date, however, is whether adding Internet retailing to the mix changes the debate.

INTERNET USE, ONLINE SHOPPING, AND FREE RIDING

The growth of online retailing in the past decade has been remarkable.[22] Because of their lower operational costs and the deep discounts that are possible as a result, Internet retailers are often portrayed as free riders.[23] The fact that Internet retailers are inherently incapable of offering a shopping environment that would allow consumers to touch a product or interact with a live salesperson also feeds into this portrayal. The popular perception is that consumers typically visit brick-and-mortar retailers to view a product, gather information, and consume a salesperson's time, only to subsequently purchase the item from an online retailer at a lower price. Thus, it is argued, there is a greater need for RPM arrangements with the advent of the Internet. A careful analysis, however, casts doubt on this narrative and on the notion that the Internet phenomenon strengthens the case for RPM.

As earlier mentioned, skepticism toward the free rider explanation for RPM is largely based on the observation that special retailer services vulnerable to free riding are seldom needed to sell most consumer goods, and few retailers provide such services.[24] The classic free rider explanation, therefore, has limited application in the real world. Adding online retailing to the mix should not diminish the strength of this critique. If no specialized retailer services are needed for the sale of music CDs, boxed candies, and the like at brick-and-mortar stores, it is hard to imagine why they would be needed when sales are made online. As to the quality certification free rider explanation, though there is no empirical data, it seems that the emergence of the Internet would only further weaken the theory. Given the ease of Internet research and the variety of independent sources of content available online, the role of the prestige retailer as a quality or style endorser should be much less important today even for the lesser-known brands. Thus, even in an Internet age, the free rider theory remains relevant only in the sale of a relatively narrow group of products—those complex products for which consumers require demonstrations or more information regarding their features and operation from knowledgeable salespeople.[25]

For a subset of products within this group—those for which sensory experience is important to generate sales—it is true that the ease and convenience of Internet shopping could indeed increase the prevalence of free riding. For free riding to occur without the Internet or online shopping, consumers would have to spend considerable time and effort visiting multiple discount stores in search of a desired item, after physically checking out the choices at a department store. The inconvenience and cost of this effort likely greatly reduce the occurrence of free riding unless the item is sufficiently expensive, and thus the cost savings sufficiently large, to justify it.

The ease of Internet searches and online shopping obviously makes shopping various stores less of a chore and less costly. The consumer now only has to visit one brick-and-mortar department store to examine the offerings (*e.g.*, try on different brands and shades of a facial foundation), mentally make her selection, and then effortlessly search the Internet for the desired item sold at a lower price by an online retailer, without facing any geographic constraints. Given the convenience of this effort with the Internet, it is reasonable to expect free riding to occur more frequently for sensory-experience products absent RPM.

Outside of this subset of products, however, the Internet may actually *reduce*, not increase, the occurrence of free riding due to a diminished need for knowledgeable in-store sales assistance. This is because of the wealth of information, such as detailed product features and specifications, professional

product reviews and user opinions that can now be found online on practically any product or service, both from online retailers' Web sites and from numerous independent sources. A consumer wishing to buy a GPS or a digital camera today, for example, can almost certainly find much more complete and accurate information on different brands and models online than she can from most sales personnel at brick-and-mortar stores.

In many respects, the capabilities of the Internet have displaced or minimized the previously important role of skilled retail salespersons in selling novel or complex information-sensitive products. Instead of in-store demonstrations, a popular traditional practice for selling these products, an Internet retailer can simply post demonstration videos, photographs, and full information on the product's features and specifications on its Web site. Professional product reviews and independent user opinions also can be very helpful in selling prospective buyers on the merits of a product, which lessens the need for retailers to educate consumers and otherwise "talk-up" the product. The success of the Kindle e-reader, sold only online through Amazon.com using these methods, is a case on point. Since its introduction in late 2007, the Kindle has become quite popular without any live retail sales assistance, despite the fact that it falls into the category of products considered information-intensive and that traditionally required product-specific retailer services. This suggests that the abundance of online content, combined with the powerful capabilities of the Internet, has greatly reduced the need for live sales assistance (and thus the potential of free riding on that assistance) even in the sale of complex and novel products.

Recent marketing studies appear consistent with this analysis in that they show many more consumers "research-shop" online and then purchase from a brick-and-mortar retailer than browse at a brick-and-mortar retailer before purchasing online.[26] Whatever the reasons for many consumers' preference for buying from a physical store after visiting online sites (perhaps for instant gratification or for peace of mind), these findings refute the popular assumption that Internet retailers are the frequent free riders and that brick-and-mortar retailers, therefore, particularly need RPM agreements to control the effects of their free riding.

A POSITIVE VIEW OF FREE RIDING

The term "free riding," unfortunately, has pejorative connotations; it conjures up images of slackers who are unjustly enriched from the efforts of others. In reality, free riding is hardly an unmitigated evil that must be rooted out wherever it may be found. Instead, it can be viewed more favorably as the positive externalities of one actor's activities benefiting another.[27] As Justice Breyer recognized in his *Leegin* dissent, free riding is ubiquitous in our economy; the law generally tolerates it, and its effects can be beneficial on balance.[28]

Though seemingly counterintuitive, the notion that free riding can be positive has found support in recent marketing research showing that free riding "across distribution channels" can be synergistic, benefiting all concerned.[29] The conventional view of free riding is that each non-buying shopper at a brick-and-mortar store who later purchases from an Internet retailer imposes a cost on the store; he or she squeezes out a would-be purchaser and consumes a salesperson's time without giving any value. The results of these studies, however, draw a different picture. They show that modest crowds of nonbuyers can *benefit*, rather than harm, a brick-and-mortar retailer by stimulating purchases from other shoppers. It is not until a store becomes very crowded and salespeople are too busy to assist potential purchasers that lower buying results.[30] In other words, having a fair number of Internet customers browsing at a brick-and-mortar store and availing themselves of its services ("free riders") may result in a net *gain* for the brick-and-mortar retailer, contrary to conventional assumptions.

Similarly, Internet retailers may also benefit from "research shoppers"—those who gather information from Internet retailer Web sites but ultimately purchase from a traditional store.[31] Research shoppers do not cost the Internet retailer much because the marginal cost of having an additional user of its Web content approaches zero. Research shoppers may even create value for the Internet retailer by contributing user reviews, making the site more valuable to other customers. Other examples of "cross-channel synergies" abound,[32] suggesting that free riding can be beneficial to brick-and-mortar and Internet retailers alike.

The positive spillover effects of free riding seen from these studies have implications for antitrust policy toward RPM agreements. If free riding can be synergistic, we should not be so quick to approve ways to deter it, especially if the method in question (RPM) prohibits retail discounting and may inhibit the growth of Internet retailing.

RPM CANNOT INDUCE INTERNET RETAILER SERVICES

Even if one rejects the new studies and insights and continues to view free riding through a conventional prism, it does not follow that RPM is an efficient response, *i.e.*, that no-discount agreements effectively encourage Internet retailers to provide the type of brick-and-mortar services upon which they are assumed to be free riding. Pure Internet retailers, by definition, are incapable of providing physical showrooms. While posting photographs of products on their Web sites is possible and often done, creating a physical environment that would allow the touching and feeling of products is impossible. Similarly, while providing online video demonstrations is possible, a non-virtual product demonstration by a live salesperson is impossible. And, while instant communication systems can be used and often are, Internet retailers cannot entirely replicate the live-salesperson-assistance experience. In short, because the nature of the services on which Internet retailers are assumed to be free riding is such that Internet retailers are physically *incapable* of providing them, RPM will not succeed in inducing these services from them.

Of course, there are other types of services that Internet retailers are not just capable of but are *better* at providing than brick-and-mortar stores. They include supplying detailed product information, photographs and video-streaming, links to professional product reviews and other helpful literature, and user opinions. But there is no evidence that Internet retailers are not already providing these services and need to be induced to do so through RPM programs. In fact, Internet retailers generally are strong opponents of RPM because losing the ability to discount would take away one of their competitive strengths. Thus, the standard argument that RPM, in eliminating intrabrand price competition, would induce a manufacturer's brick-and-mortar and Internet retailers to compete on service is not entirely persuasive.

LESS RESTRICTIVE ALTERNATIVES

It is a widely accepted tenet of US antitrust jurisprudence that, even if a trade restraint has a legitimate business justification, it can still be prohibited if there are alternative methods of achieving the objective that are less restrictive of competition. Stated differently, even if RPM is one way to control free riding problems and induce retailers to provide manufacturer-desired services, it can and should be condemned if the stated goal can be achieved through other means that are less anticompetitive.

RPM is generally acknowledged, even by its supporters, as having certain potential anticompetitive effects.[33] In *Leegin*, for example, the majority recognized that RPM can be used anticompetitively to facilitate either a manufacturer or dealer cartel.[34] It further agreed that, even in the absence of a horizontal cartel, RPM can be anticompetitive if the manufacturer adopted the arrangement due to pressure from one or more dealers acting alone, or if the manufacturer has market power.[35]

There is less agreement over what to make of empirical evidence of consistently higher consumer prices as a result of RPM.[36] The *Leegin* majority and RPM supporters attach no antitrust significance to it arguing that it can support either procompetitive or anticompetitive theories.[37] That is, higher prices would not be anticompetitive if they reflect enhanced services to consumers leading to greater demand for the good. For the dissent and RPM skeptics, however, the fact that RPM almost always produces higher prices is at least suspect.[38]

RPM's prohibition of intrabrand price competition also can adversely affect retail innovation.[39] Permitting discounting, particularly of popular brands, encourages retailers to develop new and cost-effective ways of performing normal retailing functions, charge lower prices, and increase their sales. If big-box stores such as Costco initially had little hope of increasing sales of popular brands by reducing prices, they would have had less incentive to conceive of the warehouse-club format—relying on high volume sales at narrow margins in large, no-frills settings—that has proven to be immensely successful and attractive to a large segment of consumers.

Online retailing is a major recent retail innovation. If *Leegin* results in the increased use of RPM

programs, the growth of this new channel of retailing may be threatened. It is widely acknowledged that Internet retailers' overall lower prices, made possible by their substantially lower operating costs, are a source of competitive advantage for the sector. In banning discounting, RPM would eliminate this inherent advantage. In view of the many benefits of Internet retailing, antitrust law should not so readily condone the use of this restraint if less restrictive alternatives exist—means of promoting retailer services that would not inhibit the development and growth of Internet retailing. The granting of promotional allowances, which are direct and separate payments made by manufacturers to retailers for their product-specific services, appears to be one such alternative.

Promotional allowances essentially compensate retailers for specific services and do not restrain their freedom to price the manufacturer's products as they see fit.[40] This would allow Internet retailers to pass along to consumers the benefits of their lower operational costs in the form of lower prices, in order to increase sales. In contrast, RPM agreements set a floor on retail prices to induce retailer services. They effectively prevent Internet retailers (and other more efficient retailers) from attempting to expand their sales through offering lower prices to consumers.

In addition to being less restrictive of competition, promotional allowances are probably also more efficient and effective than RPM agreements. Internet and brick-and-mortar retailers provide very different types of services (involving different costs) for a manufacturer. Promotional allowance programs would permit a manufacturer to distinguish between these services and tailor the payments accordingly. In contrast, RPM programs draw no distinctions between the types of services and their different cost structures but simply set minimum resale prices providing retailers a uniform gross margin.

More importantly, with promotional allowances, the *manufacturer* is in fact paying for the services, not the retailers. Thus, there is no true free riding no matter how consumers choose to shop.[41] If a manufacturer compensates a brick-and-mortar retailer for product demonstrations, for example, Internet retailers are not "free-riding" when they sell to consumers who have watched in-store demonstrations. And there should be minimal disincentive effect on brick-and-mortar retailers' willingness to provide the services because they are being compensated. Similarly, if Internet retailers are effectively paid for generating content on a manufacturer's products and displaying it on their Web sites, it would not be free riding if some consumers review their Web content before buying the desired item from a brick-and-mortar store.

The advantage to consumers, who are heterogeneous, is that they can shop in the manner that suits them—whether it is browsing online before buying from a brick-and-mortar store, or browsing at a brick-and-mortar store before buying online, or staying with one store from start to finish. This is particularly welfare enhancing since current marketing studies suggest that "free riding" across distribution channels can generate synergies and, on balance, benefit rather than harm consumer welfare.

Some RPM supporters contend that promotional allowances are more difficult and costly to monitor, and thus less efficient, than RPM agreements.[42] Those who make this assertion, however, seem to compare the ease of detecting discounting in the case of RPM with the difficulty of ensuring retailer performance of its special service obligations in the case of promotional allowances.[43] Ensuring that there is no surreptitious retail discounting under an RPM regime is no doubt easier and less costly than monitoring retailer provision of services for which a promotional allowance is given. But that is *not* the proper comparison to make. Just as a retailer receiving a promotional allowance may pocket the allowance without providing the service, so too can a retailer receiving an RPM margin ignore the manufacturer's service expectations and simply keep the margin. Thus, what the manufacturer must monitor in *both* situations is the provision of services: Whether a retailer is providing the services that the RPM retail margin was intended to encourage (and not merely whether it is discounting) in the case of RPM; and whether a retailer is providing the services for which it is receiving compensation, in the case of a promotional allowance. It is difficult to see how the costs of policing the retailers' service obligations in the two scenarios could be any different.

Other RPM proponents seem to simply assume that if a manufacturer chooses RPM over promotional allowances to induce services, RPM must be the more efficient strategy. It is true that if a manufacturer insists on RPM agreements on its own initiative, we can probably assume that the strategy is *privately* efficient for the manufacturer (unless the manufacturer made an error in judgment). But a manufacturer's

private efficiency is not necessarily equivalent to *social* efficiency unless the interests of manufacturers and consumers are congruent.[44] While the theory of congruence of manufacturer and consumer interests has many adherents,[45] it also has been subject to serious challenge.[46] In antitrust law, social rather than private efficiency is the appropriate measure of efficiency, and we cannot assume solely from the manufacturer's choice of RPM that it must be more efficient than other alternatives.[47]

GOING FORWARD POST-*LEEGIN*

Those less familiar with antitrust litigation may be perplexed by the controversy surrounding *Leegin*. After all, on its face, *Leegin* merely endorsed a rule of reason analysis and did not declare RPM to be per se lawful. To the extent that there is general consensus in the economic literature that RPM may have procompetitive uses, why would the adoption of a rule of reason standard for RPM generate such debate?

The reason is that, in real-world antitrust litigation, the full-fledged rule of reason often operates as a de facto legality rule. These cases are notoriously expensive and difficult to litigate, and often degenerate into dueling matches between competing economic experts with contradictory economic theories on market definition, elasticity of demand or supply, entry barriers, and such. Judge Richard Posner has described the rule of reason as "in practice . . . no more than a euphemism for nonliability."[48] Judge Douglas Ginsburg of the DC Circuit Court of Appeals, who formerly headed the Antitrust Division of the Department of Justice in the Reagan administration, has likewise characterized the rule as one of de facto legality.[49] Other commentators have made similar observations, portraying it as presenting "a defendant's paradise,"[50] or as "a euphemism for endless economic inquiry resulting in a defense verdict."[51] This common knowledge about the realities of antitrust litigation is also confirmed by empirical data.[52]

Moreover, after *Sylvania*,[53] several circuit courts went further and adopted a market power screen[54] on the theory that firms without market power cannot injure competition.[55] Other circuits, however, noted that proof of market power is merely a proxy for demonstrating anticompetitive effects[56] and, thus, direct evidence of anticompetitive effects obviates the need for such proof.[57] Where market power is considered a prerequisite to establishing an illegal vertical nonprice restraint, few plaintiffs have ever survived a motion for summary judgment.[58] In fact, given the strict pleading standards recently articulated by the Court in *Bell Atlantic Corp. v. Twombly*,[59] these plaintiffs would probably have difficulty today withstanding a motion to dismiss on the pleadings.

Indeed, in the only two RPM cases that have reached the federal appellate courts post-*Leegin*, the Fifth and the Eleventh Circuits have both upheld the dismissal of plaintiffs' complaints under Rule 12(b)(6) for failure to sufficiently allege a plausible relevant product market (and, thus, defendants' market power).[60] The Eleventh Circuit in *Jacobs v. Tempur-Pedic International* apparently read *Leegin* and *Twombly* together to require the RPM plaintiffs to provide "factual allegations of the cross elasticity of demand or other indications of price sensitivity" to define the relevant market,[61] which they had not done.

This strict approach to the rule of reason (both on proof and pleading) seems, not merely unnecessary, but inconsistent with *Leegin* and, therefore, should not be applied to RPM agreements. The *Leegin* opinion shows that the Court did not envision de facto *legality* for RPM, notwithstanding the reality of the application of the rule of reason in vertical nonprice restraint cases. This can be seen from the Court's admonishment of lower courts to be "diligent in eliminating [RPM's] anticompetitive uses from the market,"[62] its identification of three non-exhaustive factors to be considered in applying the rule of reason,[63] and its suggestion for the development of "presumptions, where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."[64]

Nor did *Leegin* endorse a market power screen for RPM. All the Court said about market power was that "if a manufacturer lacks market power, there is less likelihood that it can use the practice to keep competitors away from distribution outlets."[65] Moreover, of the three factors that the Court said were relevant in a rule of reason analysis of RPM, only one involved manufacturer market power; the other two were whether the practice reflected "retailer pressure" and whether "many competing manufacturers adopted the practice."[66] Clearly, had *Leegin* intended to impose a market power screen, it would not have suggested

that lower courts consider these two non-market power factors.

From a policy perspective, it is unwise to apply the "normal" rule of reason standard, *i.e.*, de facto legality, to RPM agreements because, as discussed, these restraints pose substantial competitive risks, especially to Internet retailing. Instead, a rebuttable presumption of illegality framework is more desirable, and also seems consistent with *Leegin* in light of the language of the opinion. A rebuttable presumption of illegality is akin to the *Polygram* approach[67] and to the quick-look rule of reason commonly applied in modern antitrust horizontal restraint cases.[68] Under this approach, so long as the plaintiff shows an RPM agreement and higher resale prices, and no apparent procompetitive reason exists for the agreement, a prima facie case would be established.

To rebut the presumption of illegality, *Polygram* allows a defendant to come forward with reasons showing why a restraint that is generally considered competitively suspect may not be anticompetitive in the context of the particular market or is likely to benefit consumers.[69] In RPM cases affecting Internet retailing, a defendant could show, for example, that the product is the type that few consumers would buy without first visiting a store, and free riding on physical store services by Internet retailers is likely to be rampant. Or it might show that only one or two non-dominant manufacturers among many in the relevant market have adopted, voluntarily, RPM programs. Or it could present evidence that the manufacturer is a new entrant whose RPM agreements are unlikely to have anticompetitive effects.[70]

Even if *Leegin* is interpreted to demand more of the plaintiff, it cannot reasonably be read to require a manufacturer market power screen. Therefore, at a minimum, if an RPM plaintiff can show one of the other two (non market power) "*Leegin* factors" or actual anticompetitive effects, the finding of an illegal RPM agreement should be permissible even absent proof of manufacturer market power.[71] For example, proof that a manufacturer implemented an RPM program in response to a retailer's pressure, leading to higher prices or less output should be sufficient to establish a prima facie case. This would help plaintiffs at least survive a motion to dismiss for failure to allege sufficient facts to strictly define the relevant market.

CONCLUSION

The primary efficiency claim asserted by RPM supporters for the practice is that it remedies free rider effects and induces retailer services. Though the relevant economics literature is largely silent on the advent of the Internet, there is a common perception that Internet retailers only exacerbate the problem and strengthen the free rider argument for RPM. An analysis of the characteristics of the Internet, Internet retailing, and the issues they raise pertaining to the free-rider theory suggests, however, little support for these assumptions. Moreover, recent marketing research finds that "free riding" can be synergistic and beneficial to Internet and brick-and-mortar retailers alike. Given these new insights, we should not be so quick to condone RPM, a practice that could seriously impact the growth of Internet retailing, especially when there are less restrictive alternatives available.

The problem with a full-fledged rule of reason analysis in antitrust is that it tends to morph into a de facto legality rule. But *Leegin* does not endorse such an approach. It instructed lower courts to "diligently" identify and prohibit anticompetitive uses of RPM, which indicates that the Court envisioned something other than the normal rule-of-reason application that is employed in vertical nonprice restraint cases after *Sylvania*. Ideally, a rebuttable presumption of illegality can be applied. But even assuming that *Leegin* is interpreted to impose a weightier burden on plaintiffs, a market power screen is neither necessary nor desirable.

NOTES

1. Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
2. Leegin Creative Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).
3. Vertical nonprice restraints are restrictions on intrabrand competition (unrelated to price) that are imposed by a manufacturer on distributors of its brand, e.g., location clauses in distribution agreements limiting dealers to selling the manufacturer's products only within a designated territory.
4. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). *See, e.g.*, Richard A. Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," 45 *U.Chi. L. Rev.* 1, 14 (1977) (characterizing the rule of reason as "little more than a euphemism for nonliability"); Douglas H. Ginsburg, "Vertical Restraints: De Facto Legality Under the Rule of Reason," 60 *Antitrust L.J.* 67 (1991).
5. In the three years since *Leegin* was decided, several courts have already dismissed RPM complaints for failure to properly allege a relevant market and defendant's market power. *See* Jacobs

v. Tempur-pedic Int'l, Inc., __ F.3d __ (11th Cir. 2010), 2010 WL 4880864; PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 2009 WL 938561 (E.D. Tex. 2009), *aff'd* 615 F.3d 412 (5th Cir. 2010); Spahr v. Leegin Creative Leather Prods., Inc., 2008 WL 3914461 (E.D. Tenn. 2008). *But see* BabyAge.com v. Toys "R" Us, Inc., 558 FSupp. 2d 575 (E.D. Pa. 2008).

6. *See* Joseph Pereira, "Price Fixing Makes Comeback After Supreme Court Ruling," *Wall St. J.*, Aug. 18, 2008, at A1; Joseph Pereira, "Why Some Toys Don't Get Discounted—Manufacturers Set Minimums That Retailers Must Follow or Risk Getting Cut Off," *Wall St. J.*, Dec. 24, 2008, at D1; Joseph Pereira, "Discounters, Monitors Face Battle on Minimum Pricing," *Wall St. J.*, Dec. 4, 2008, at A1.

7. *See* BabyAge.com, Inc. v. Toys "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. 2008); McDonough v. Toys "R" Us, Inc., 638 F. Supp. 2d 461 (E.D. Pa. 2009) (a class-action suit making similar allegations against Babies "R" Us). These cases, unlike other post-*Leegin* RPM cases, have managed to survive motions to dismiss. *See also* WorldHomeCenter.com, Inc. v. L.D. Kichler Co., Inc., No. 05-CV-3297 (DRG)(ARL), (E.D.N.Y. Mar. 28, 2007).

8. *See Leegin*, 551 U.S. at 889-892 (citing to and discussing some of the literature).

9. For the few articles that have mentioned the Internet and resale price maintenance or free rider issues, *see* Roger D. Blair & Jessica S. Haynes, "The Plight of Online Retailers in the Aftermath of Leegin: An Economic Analysis," 55 *Antitrust Bull.* 245 (2010); Gregory T. Gundlach, Joseph P. Cannon & Kenneth C. Manning, "Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice," 55 *Antitrust Bull.* 381 (2010); Marina Lao, "Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues," 55 *Antitrust Bull.* 473 (2010); Note, Leegin's Unexplored "'Change in Circumstance': The Internet and Resale Price Maintenance," 121 *Harv. L. Rev.* 1600, 1612-1618 (2008); Dennis W. Carlton & Judith A. Chevalier, "Free Riding and Sales Strategies for the Internet," 49 *J. Indus. Econ.* 441 (2001); Sebastian Van Baal & Christian Dach, "Free Riding and Customer Retention Across Retailers' Channels," 19 J. *Interactive Marketing* 75 (2005).

10. *See* Gundlach et al., *supra* n. 9 at 393-395 (surveying several studies showing that many more shoppers browse online before buying from brick-and-mortar stores than browse at brick-and-mortar stores before buying online); Jie Zhang et al., "Crafting Integrated Multichannel Retailing Strategies," working paper, Harvard Business School, available at *http://hbswk.hbs.edu/6181.html*; Peter C. Verhoef, Scott A. Neslin and Bjorn Vroomen, "Multichannel Customer Management: Understanding the Research-Shopper Phenomenon," *Int'l J. Res. Marketing* 24, 129 (2007).

11. Gundlach et al., *supra* note 9, at 402-403, 420-421.

12. *See Leegin*, 551 U.S. at 892-894.

13. *See, e.g.*, Cont'l T.V., Inc. v. GTE Sylvania, Inc., 443 U.S. 36 (1977) (relying extensively on the free rider theory in adopting the rule of reason for vertical nonprice restraints); Bus. Elecs. v. Sharp Elecs. Corp., 485 U.S. 717 (1988); Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007); FTC v. Levi Strauss & Co., 92 F.T.C. 171 (1978) (arguing RPM agreements were needed to prevent consumers from going to full-service retailers to try out the jeans and then buying them at discount stores that did not provide dressing rooms).

14. *See* Lester G. Telser, "Why Should Manufacturers Want Fair Trade?," 3 *J.L. & Econ.* 86 (1960). Telser's theory is drawn from, and built upon, earlier work by Ward Bowman and B.S. Yamey. *See* Ward Bowman, "The Prerequisites and Effects of Resale Price Maintenance," 22 *U. Chi. L. Rev.* 825 (1955); B.S. Yamey, "The Economics of Resale Price Maintenance 3-27" (1954).

15. *See* Howard P. Marvel & Stephen McCafferty, "Resale Price Maintenance and Quality Certification," 15 *Rand J. Econ.* 346 (1984).

16. *See Leegin*, 551 U.S. at 915-916 (Breyer, J., dissenting) (noting that economists disagree on how often free riding actually occurs, how significant its effects, and thus how common it is for RPM to confer benefits).

17. *Id.* at 915.

18. *See, e.g.*, Robert Pitofsky, "Why Dr. Miles Was Right," 8 *Regulation* 27, at 29-30 (1984).

19. *See id* at 29; E. Corey, "Fair Trade Pricing: A Reappraisal," *Harv. Bus. Rev.* 42 (Sept.-Oct. 1952) at 47.

20. *See* Nine West Group, Inc., No. C-3937, 2008 WL 2061410 (F.T.C.); Keds Corp., 117 F.T.C. 389 (Apr. 1, 1994); Reebok Int'l Ltd., 120 F.T.C. 20 (July 18, 1995); New Balance Athletic Shoe, Inc., 122 F.T.C. 137 (Sept. 10, 1996).

21. *Leegin*, 551 U.S. at 916 (Breyer, J., dissenting).

22. Internet sales grew at an average annual rate of 23.1 percent from 2002 to 2007 while the annual total retail sales growth for the comparable period was only 5 percent. Between 2006 and 2007, Internet retail sales increased 18.4 percent as compared to a mere 3.2 percent gain for total retail sales. U.S. Census Bureau, E-Stats 1-3 (May 28, 2009), available at *http://www.census.gov/econ/estats/2007/2007reportfinal.pdf*.

23. *See* Brief for the United States as Amicus Curiae Supporting Petitioner at 13, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (stating that free riding is "exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the product at a discounted price from a catalog or online retailer.")

24. Of course, retailers also offer (and compete on) intangible services, but intangible services are generally not susceptible to free riding. Customers cannot benefit from one store's pleasant ambience, efficient employees, for example, while patronizing another store. *See* Marina Lao, "Free Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance, in How the Chicago School Overshot the Mark" 196, 202-03 (Robert Pitofsky ed., 2008).

25. *See* Lao, "Free Rider Explanation," supra n. 24, at 200-01.

26. *See* Zhang et al., supra n. 10 (reporting on IBM-conducted survey that showed 78 percent of responders gathered information on the Internet before purchasing from a brick-and-mortar store while only 8 percent browsed at a store before buying online); Peter C. Verhoef, Scott A. Neslin & Bjorn Vroomen, "Multichannel Customer Management: Understanding the Research Shopper Phenomenon," *Int'l J. Res. Marketing* 24, 129 (2007) (reporting on Doubleclick-conducted study showing that 43 percent of shoppers reported browsing on the Internet before purchasing at stores, as compared to 16 percent of shoppers who browsed at stores before purchasing online); Gundlach et al., *supra* n. 9, at n.40.

27. *See* Lao, Free Rider Explanation, *supra* n. 24, at 207-209.

28. *Leegin*, 551 U.S. at 915 (Breyer, J., dissenting) ("But 'free riding' often takes place in the economy without any legal effort to stop it. Many visitors to California take free rides on the Pacific Coast Highway. We all benefit freely from ideas, such as that of creating the first supermarket. Dealers often take a 'free ride' on investments that others have made in building a product's name and reputation.").

29. *See* Chip E. Miller, James Reardon & Danny E. McCorkle, "The Effects of Competition on Retail Structure: An Examination of Intratype, Intertype, and Intercategory Competition," 63 *J. Marketing* 107, 107 (1999) (discussing different types of retailers and suggesting that the relationship among them can be symbiotic); Sebastian Van Baal & Christian Dach, "Free Riding and Customer Retention Across Retailers' Channels," 19 *J. Interactive Marketing* 75, 76 (2005); Gundlach et al., *supra* n. 9, at 391-396.

30. *See* Sevgin Eroglu, Karen Machleit & Terri Feldman Barr, "Perceived Retail Crowding and Shopping Satisfaction: the Role

of Shopping Values," 58 *J. Bus. Res.* 1146 (2005); Gundlach et al., *supra* n. 9, at 420-421.

31. *See* Gundlach et al., *supra* n. 9, at 421-422.
32. *See id.* at 407-411.
33. *See, e.g.*, Richard Posner, Antitrust Law 172 (2d ed. 2001); Howard P. Marvel & Stephen McCafferty, "The Welfare Effects of Resale Price Maintenance," 28 *J.L. & Econ.* 363, 373 (1985).
34. *Leegin*, 551 U.S. 877, 892-893 (2007).
35. *Id.* at 893-894.
36. In 1937, Congress passed the Miller-Tydings Fair Trade Act allowing states to override Dr. Miles by passing state laws specifically permitting RPM agreements within their states. A total of 36 states experimented with legalizing RPM at some point until Miller-Tydings was repealed in 1975. Subsequent empirical studies conducted showed consumer prices were 19 to 27 percent higher in states that had passed laws legalizing RPM than in states that had not. *See* Thomas R. Overstreet, Jr., "Resale Price Maintenance: Economic Theories and Empirical Evidence," 160 (Bureau of Econ., Fed. Trade Comm'n 1983).
37. *Leegin*, 551 U.S. at 895-896.
38. *Id.* at 912 (Breyer, J., dissenting) ("Those who express concern about the potential anticompetitive effects find empirical support in the behavior of prices . . . "). It is hard to see, for example, what sort of enhanced value consumers could conceivably receive in return for higher prices for many consumer goods such as music CDs, light bulbs, men's underwear, boxed candy, to name some of the many items for which higher prices had been observed under RPM.
39. *See* Marina Lao, Resale Price Maintenance: A Reassessment of Its Competitive Harms and Benefits, in More Common Ground for International Competition Law, at Part 3.1.2 (Josef Drexl et al., eds., 2011) (forthcoming), available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1434984*.
40. *See* Warren S. Grimes, "Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints," 64 *Antitrust L.J.* 83, 101 (1995). *See also* Robert L. Steiner, "Manufacturers' Promotional Allowances, Free Riders and Vertical Restraints," 36 *Antitrust Bull.* 383 (1991) (arguing strongly that promotional allowances, not RPM, would better promote dealer services).
41. *See* Toys 'R' Us v. Fed. Trade Comm'n, 221 F.3d 928, 938 (7th Cir. 2000) (concluding that when Toys 'R' Us received separate compensation from toy manufacturers for performing specific retailer services, "there was little or no opportunity to 'free' ride on anything").
42. *See* Bowman, *supra* n. 14; Richard A. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," 48 *U. Chi. L. Rev.* 6 (1981); Robert Bork, The Antitrust Paradox 291; Lester Telser, "Why Should Manufacturers Want Fair Trade II?," 33 *J.L. & Econ.* 409 (1990).
43. *See, e.g.*, Telser, *supra* n. 14, at 94 ("[I]t is easier to police violations of minimum prices than to survey retailers to see that they do indeed provide the special services and do not simply fritter away the direct payments.").
44. *See* Lao, Resale Price Maintenance: The Internet Phenomenon and Free Rider Issues, *supra* n. 9 at 497-500.
45. *See, e.g.*, *Leegin*, 551 U.S. at 895 ("As a general matter, therefore, 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.'") (*citing* Frank Mathewson & Ralph Winter, "The Law and Economics of Resale Price Maintenance," 13 *Rev. Indus. Org.* 57, 74-75 (1998)). *See also* Robert Bork, "The Rule of Reason and the Per Se Concept: Price Fixing and Market Division (pt. 2)," 75 *Yale L.J.* 373 (1996),
46. *See* William S. Comanor, "Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy," 98 *Harv. L. Rev.* 983 (1984).
47. *See* Lao, "Resale Price Maintenance: A Reassessment," *supra* n. 39, at Part 3.2.2.2.
48. Richard A. Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," 45 *U. Chi. L. Rev.* 1, 14 (1977).
49. Douglas H. Ginsburg, "Vertical Restraints: De Facto Legality Under the Rule of Reason," 60 *Antitrust L.J.* 67, 71 (1991).
50. Stephen Calkins, "California Dental Association: Not a Quick Look But Not the Full Monty," 67 *Antitrust L.J.* 495, 521 (1999).
51. Maxwell M. Blecher, "Schwinn—An Example of Genuine Commitment to Antitrust Law," 44 *Antitrust L.J.* 550, 553 (1975).
52. *See* Michael A. Carrier, "The Rule of Reason: An Empirical Update for the 21st Century," 16 *Geo. Mason L. Rev.* 827, 829 (2009) (examining all 222 rule of reason cases that reached final judgment in the last decade and finding that defendant won 221, or 99.6 percent); Ginsburg, *supra* n. 49, at 71 (examining all 45 vertical nonprice restraint cases brought between 1977 and 1991, and finding that plaintiffs lost over 90 percent).
53. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) (replacing the per se rule with the rule of reason for vertical nonprice restraint cases).
54. *See, e.g.*, Republic Tobacco v. North Atlantic Trading, 381 F.3d 717, 737 (7th Cir. 2004); Murrow Furniture v. Thomasville Furniture, 889 F.2d 524, 528 (4th Cir. 1989); Valley Liquors, Inc. v. Renfield Importers, Ltd., 822 F.2d 656, 669 (7th Cir. 1987); Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 221 (D.C. Cir. 1986).
55. *See* Frank H. Easterbrook, "The Limits of Antitrust," 63 *Tex. L. Rev.* 1, 20-21 (1984).
56. *See* FTC v. Indiana Federation of Dentists, 476 U.S. 447, 460 (1986). Though the case involved a horizontal restraint, the Court's statement was a general one relating to the application of the rule of reason and did not distinguish between horizontal and vertical restraints.
57. *See, e.g.*, K.M.B. Warehouse v. Walker Manufacturing, 61 F.3d 123, 128-219 (2d Cir. 1995); Ryko Manufacturing v. Eden Services, 823 F.2d 1215, 1231 n.14 (8th Cir. 1987); Oltz v. St. Peter's Community Hospital, 861 F.2d 1440, 1448 (9th Cir. 1998).
58. *See* Richard M. Steuer, "The Turning Points in Distribution Law," 35 *Antitrust Bull.* 467, 513-518 (1990) (summarizing cases that have applied the market-power screen).
59. Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).
60. PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 615 F.3d 412, 417 (5th Cir. 2010); Jacobs v. Tempur-Pedic Int'l., ___ F.3d ___ (11th Cir. 2010), 2010 WL 4880864 at 4-6. *See also* Spahr v. Leegin Creative Leather Prods., Inc., 2008 WL3914461 (E.D. Tenn. 2008). *But see* BabyAge.com v. Toys 'R' Us, Inc., 558 F.Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss).
61. *Jacobs*, 2010 WL 4880864 at 5.
62. *Leegin*, 551 U.S. at 897.
63. *Id.* at 897-898.
64. *Id.* at 898-899.
65. *Id.* at 897-898.
66. *Id.*
67. Polygram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005). Polygram endorsed the FTC's Mass. Board legal framework, which had found that conduct that appears likely to restrict competition would be presumed illegal, absent an efficiency justification. Polygram is a horizontal restraint case but there is no reason a similar framework cannot apply to vertical restraints as well.
68. *See* Nat'l Soc'y of Prof'l Eng'rs v. FTC, 435 U.S. 679 (1978); NCAA v. Board of Regents, 468 U.S. 85 (1984); FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1987). In all three cases, the Court applied what later became known as the quick-look rule of reason.

In none of these cases did the Court insist on an elaborate, formal, market analysis—delineating the relevant market and then proving defendant's market power.

69. *Polygram*, 416 F.3d at 36.

70. If the defendant makes a sufficient showing to satisfy this burden of production, the burden would shift back to the plaintiff to show the existence of alternative means of controlling free rider problems and promote dealer services that are less anticompetitive than RPM but equally effective and efficient.

71. *See* In re Nine West Group, Inc., FTC Dkt. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, at 14-15, 2008 WL 2061410 (stating that, if one of the three *Leegin* factors were present, "closer analytical scrutiny, such as that anticipated by *Polygram Holding* [] or other truncated rule of reason analysis" would be appropriate).

Resale price maintenance: The Internet phenomenon and free rider issues

BY MARINA LAO*

This article looks at Internet retailing and the free rider justification often asserted for resale price maintenance (RPM). It argues that the case for RPM as a means to control free rider problems is not strengthened by the advent of Internet retailers. While the Internet may increase the occurrence of free riding for some products, it may also reduce it for others. In fact, recent marketing studies tend to dispel the popular perception that Internet retailers are frequent free riders and that free riding is necessarily harmful. These new insights call into question the general assumption that free riding must be discouraged. But even if we view free riding from a conventional perspective, RPM may not be the most effective way to induce retailer services. In view of the many benefits of Internet retailing, antitrust law should disfavor a trade restraint that inhibits its growth, such as RPM, if there are alternative means of promoting retailer services that do not present similar risks. Promotional allowances could be such an alternative. The article concludes by explaining why a full rule of reason analysis is unworkable and suggests a rebuttable presumption of illegality as an alternative approach.

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I. INTRODUCTION

The per se rule against minimum resale price maintenance (RPM),[1] which traces its origins to *Dr. Miles*,[2] had endured for almost a century when it was overruled in *Leegin* in 2007.[3] In overruling *Dr. Miles* in favor of the rule of reason—a rule Richard Posner has described as "little more than a euphemism for nonliability"[4]—the *Leegin* Court relied heavily on economics literature to identify possible benefits for RPM.[5] The benefit most widely asserted is that RPM, or vertical price fixing, can control free rider problems, and thereby encourage dealer services, promote interbrand competition, and enhance consumer welfare.[6] While much has been written on resale price maintenance and the free rider explanation, commentators have largely overlooked the increasing importance of Internet use

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[1] For convenience, unless otherwise noted, I use the term RPM to refer to *minimum* resale price maintenance (without specifically including the qualifier "minimum").

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

[3] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

[4] Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1, 14 (1977). *See infra* notes 125–36 and accompanying text (discussing further why the full rule of reason operates effectively as a de facto legality rule and referring to studies supporting that conclusion).

[5] *Leegin*, 551 U.S. at 889–90. The majority and dissent also had differing views on stare decisis. Kennedy, writing for the majority, concluded that stare decisis did not compel affirming *Dr. Miles*. *See Leegin*, 551 U.S. at 900. In contrast, Breyer placed greater weight on stare decisis and found "no change in circumstances" that would support changing the long-established per se rule against RPM by overturning *Dr. Miles*. *See id.* at 919 (Breyer, J., dissenting).

[6] *See, e.g.*, Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86, 91 (1960); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 283 (1991) (concluding from her study that the free rider theory was possibly "a major explanation" for the use of RPM); ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 297 (1978) (asserting that the motivation for RPM must be for the "inducement or purchase by the manufacturer of extra reseller sales, services, or promotional effort" and thus advocating per se legality for the practice).

and Internet retailing in the past decade.[7] Perhaps because of that, *Leegin* never considered how this Internet phenomenon might affect the arguments offered both for and against RPM, particularly in relation to the free rider justification.[8] Yet, the decision is likely to have a disproportionate impact on Internet retailers since the ability to charge lower prices, which RPM forbids, is a particular source of strength for them.

The free rider debate in relation to RPM has usually focused on the actual significance of the justification and whether it is more theoretical than practical. Skeptics argue that, while the explanation is theoretically valid, it has limited applicability because few products require specialized dealer services for effective marketing and few dealers provide them. The issue is whether adding Internet retailing to the mix changes this basic argument.

The Internet and Internet retailing have substantially changed the way many consumers shop. Some characteristics of the Internet, such as the ease and convenience of online shopping, are conducive to free riding on brick-and-mortar stores for products that depend on sensory experience for sales. But they may *reduce* free riding on physical store services for other products, because the wealth of information

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[7] For the few articles that have mentioned the Internet and resale price maintenance or free rider issues, see Note, Leegin's *Unexplored "Change in Circumstance": The Internet and Resale Price Maintenance*, 121 HARV. L. REV. 1600, 1612–18 (2008); Dennis W. Carlton & Judith A. Chevalier, *Free Riding and Sales Strategies for the Internet*, 49 J. INDUS. ECON. 441 (2001); Daniel B. Nixa, Note, *Internet Retailers and Intertype Competition: How the Supreme Court's Incomplete Analysis in* Leegin v. PSKS *Leaves Lower Courts Improperly Equipped to Consider Modern Resale Price Maintenance Agreements*, 11 VAND. J. ENT. & TECH. L. 461 (2009); Erich M. Fabricius, Note, *The Death of Discount Online Retailing? Resale Price Maintenance After* Leegin v. PSKS, 9 N.C. J.L. & TECH. 87 (2007); Sebastian Van Baal & Christian Dach, *Free Riding and Customer Retention Across Retailers' Channels*, 19 J. INTERACTIVE MARKETING 75 (2005); Gregory T. Gundlach, Joseph P. Cannon & Kenneth C. Manning, *Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice*, in this issue of the *Antitrust Bulletin*.

[8] Justice Breyer's dissent in *Leegin* included two parenthetical and offhand references to Internet retailers, *Leegin*, 551 U.S. at 922, 925 (Breyer, J., dissenting), while Kennedy's majority opinion made no mention of them at all.

online would likely minimize the need for in-person retailer service. In fact, recent marketing studies suggest that, contrary to popular assumptions, free riding occurs more often in the *opposite* direction—customers "research shopping" on an Internet retailer's website, but buying from a brick-and-mortar retailer[9]—yet Internet retailers are opponents, not supporters, of RPM. Research also suggests that free riding between brick-and-mortar and Internet retailers ("across distribution channels") can be synergistic, benefiting both types of retailers.[10] I conclude, therefore, that Internet retailing, on balance, does not strengthen (and perhaps even weakens) the free rider explanation for RPM.

Moreover, in antitrust, even if a trade restraint has a legitimate justification, it can be prohibited if there are alternatives to achieving the objective that are less restrictive of competition. I argue that RPM is not the least restrictive means of promoting retailer services. First, it is ineffective in eliciting from Internet retailers the type of brick-and-mortar store services upon which they are allegedly free riding—e.g., actual showrooms and live, knowledgeable, sales staff—for the simple reason that Internet retailers are physically incapable of providing those services. Second, manufacturers are usually guided by private efficiency, not social efficiency, in deciding on the types and levels of service to induce. Thus, we cannot assume that the level (and nature) of service they choose to encourage is necessarily socially optimal; RPM agreements may, in fact, promote an excessive amount of certain services.

There are at least two alternatives that would induce retailer services but, unlike RPM, would not prohibit intrabrand price competition: promotional allowances for most products and limited distribution (excluding the Internet channel) for products that consumers are unwilling to purchase online without first visiting a store. Promotional allowances are more efficient than RPM because they are targeted toward the actual services provided, instead of giving a uniform gross margin to all despite the very different types of services Internet and brick-and-mortar retailers provide. They would also

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[9] *See* Gundlach, Cannon & Manning, *supra* note 7, at III.A.1.

[10] *See id.*

allow consumers to shop in the manner that suits them because, when manufacturers pay for the services, it does not matter whether customers browse at one store but buy from another. This is particularly welfare enhancing if free riding can be synergistic, as some current studies suggest.[11] For products that few consumers would purchase without first visiting a store, limited distribution (excluding Internet retailers) is a better alternative than RPM because excluding Internet sales would not inconvenience buyers; manufacturers are also likely to use this restriction judiciously because, with the growing popularity of Internet shopping, they would not lightly decide to exclude the Internet channel of distribution.

I begin, in part II, with a brief discussion of the general debate of the free riding explanation for RPM. In part III, I analyze the impact of the Internet on the free riding explanation and conclude that it does not, on balance, strengthen arguments supporting the explanation. In part IV, I explore why RPM may not be a desirable response to free riding. In part V, I make the case for promotional allowances or, in some circumstances, limited distribution as less restrictive alternatives to RPM. I conclude, in part VI, by proposing a rebuttable presumption of illegality approach for evaluating RPM agreements going forward.

II. THE FREE RIDER EXPLANATION FOR RESALE PRICE MAINTENANCE

A. The classic theory: free riding on tangible services

Eliminating free rider effects to induce dealer services is the primary efficiency explanation that RPM supporters offer for the practice,[12]

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[11] *See infra* part IV.A.

[12] *See, e.g.*, Cont'l T.V., Inc. v. GTE Sylvania, Inc., 443 U.S. 36 (1977) (relying extensively on the free rider theory in adopting the rule of reason for vertical nonprice restraints); Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988); Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007); FTC v. Levi Strauss & Co., 92 F.T.C. 171 (1978) (arguing that RPM agreements were needed to prevent consumers from going to full-service retailers to try out the jeans and then buying them at discount stores that did not provide dressing rooms).

though a few non–free rider procompetitive theories also exist.[13] This explanation was largely responsible for the Supreme Court's decision in *Sylvania* to overrule an earlier precedent and to apply the rule of reason to nonprice distribution restraints.[14] It was also a rationale for the divided Court's 5–4 decision in *Leegin* to overrule *Dr. Miles* and end per se treatment for RPM.[15] In a nutshell, the classic free rider theory posits that certain retailer services that cannot be charged separately to consumers, such as product demonstrations and information, may help sell a product.[16] But if consumers can take advantage of the special services provided by one retailer and then buy at a discount from another who offers no such services, there would be little incentive for retailers to provide the desired services leading to an overall decrease in demand. By banning discounting, RPM is said to remedy the free rider problem and encourage retailer services.[17]

While there is consensus that this hypothesis is theoretically valid, empirical evidence is limited,[18] and there is considerable skepticism of the broad claim that RPM is usually explicable as an efficient response

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[13] *See, e.g.*, Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free Riding*, 76 ANTITRUST L.J. 431 (2009); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AM. ECON. REV. 619 (1997); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. ECON. 61 (1993).

[14] *Sylvania*, 433 U.S. at 54–55 (overruling *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

[15] *Leegin*, 551 U.S. at 889–90.

[16] *See* Telser, *supra* note 6. Telser's theory is drawn from, and built upon, earlier work by Ward Bowman and Basil S. Yamey. *See* Ward Bowman, *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825 (1955) and BASIL S. YAMEY, THE ECONOMICS OF RESALE PRICE MAINTENANCE 3–27 (1954).

[17] *See generally* Telser, *supra* note 6; RICHARD A. POSNER, ANTITRUST LAW 172–73 (2d ed. 2001); and BORK, *supra* note 6, at 290–91.

[18] *See Leegin*, 551 U.S. at 894 (acknowledging that the empirical evidence was limited but citing two studies to say that it at least "does not suggest efficient uses of [RPM] are infrequent or hypothetical). The *Leegin* dissent noted flaws in both studies. *Id.* at 920 (Breyer, J., dissenting).

to free riding.[19] Breyer, for example, rhetorically asked in his *Leegin* dissent "how often the 'free riding' problem is serious enough to significantly deter dealer investment."[20] Even Benjamin Klein, a strong RPM supporter, agrees that the free rider explanation has limited applicability and is sometimes "clearly pretexual."[21]

The classic example of free riding usually given involves the sale of complex products, such as sophisticated audio and video equipment, for which showrooms, product demonstrations, and knowledgeable sales assistance are important,[22] and which are typically expensive and infrequently purchased.[23] Outside this relatively narrow range of products, however, the classic free rider theory does not readily explain many instances of RPM. As Robert Pitofsky and others have noted, very few products require dealer demonstrations, consumer education, operational expertise, special showrooms and the like[24]—

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[19] *See, e.g.*, Robert Pitofsky, *Why* Dr. Miles *Was Right*, 8 REGULATION 27, 29 (1984); Kevin Arquit, *Resale Price Maintenance: Consumers' Friend or Foe?*, 60 ANTITRUST L.J. 447, 452 (1991); Stanley Ornstein, *Resale Price Maintenance and Cartels*, 30 ANTITRUST BULL. 401, 428 (1985); Brief for William S. Comanor and Frederic M. Scherer as Amici Curiae Supporting Neither Party at 6; Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (No. 06-480) [hereinafter Brief of Amici Comanor and Scherer]; 8 PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1601e, at 13 (Aspen 2d ed. 2004); Marina Lao, *Free Riding: An Overstated, and Unconvincing, Explanation for Resale Price Maintenance*, *in* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 196, 201–02 (Robert Pitofsky ed., 2008).

[20] *Leegin*, 551 U.S. at 914–15 (Breyer, J., dissenting).

[21] Klein, *supra* note 13, at 432–34. *See also* Howard Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 ANTITRUST L.J. 59 (1994).

[22] Robert Pitofsky, *Are Retailers Who Offer Discounts Really "Knaves"?: The Coming Challenge to the* Dr. Miles *Rule*, 21 ANTITRUST 61 (2007).

[23] *See* Benjamin Klein, *Distribution Restrictions Operate by Creating Dealer Profits: Explaining the Use of Maximum Resale Price Maintenance in* State Oil v. Khan, 7 SUP. CT. ECON. REV. 1, 6–7 (1999) (noting that it is cost effective for consumers making large purchases to shop multiple stores).

[24] Pitofsky, *supra* note 19, at 29–30. *See also* Brief of Amici Comanor and Scherer, *supra* note 19, at 6; 8 AREEDA & HOVENKAMP, *supra* note 19, ¶1601e, at 13; Ornstein, *supra* note 19, at 428; Arquit, *supra* note 19, at 452; Lao, *supra* note 19, at 201–02.

that is, services specific to a product that are not separately chargeable to buyers and, thus, susceptible to free riding. And few retailers actually provide such services.[25] Yet resale price maintenance has been adopted for products such as boxed candy, pet foods, jeans, vitamins, shampoo, knit shirts, men's underwear,[26] shoes,[27] and women's handbags.[28]

Even for the limited group of products for which special retailer services are helpful, the significance of the free riding problem is questionable. As Breyer noted in his *Leegin* dissent, despite *Dr. Miles*'s longstanding per se prohibitions against RPM, many retailers do sell complex technical equipment or high-end goods to consumers,[29] and there is no evidence of underprovision of such goods (or of stores selling such goods) in our economy.

Noticeably missing from the free rider discourse to date is much discussion of Internet retailing and its likely impact on either side of the argument—such as whether the free rider explanation for RPM is more or less credible, and whether RPM is a more or less effective and efficient tool for controlling free riding problems, with the advent of the Internet. In its *Leegin* amicus brief supporting the petitioner's quest to overrule *Dr. Miles*, the United States stated that the free rider problem "is exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the

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[25] *See* Pitofsky, *supra* note 19, at 29–30, and E. Corey, *Fair Trading Pricing: A Reappraisal*, HARV. BUS. REV., Sept.–Oct. 1952, at 42, 47.

[26] Pitofsky, *supra* note 22, at 61, 63.

[27] *See* Nine West Group, Inc., No. C-3937, 2008 WL 2061410 (F.T.C.); Keds Corp., 117 F.T.C. 389 (Apr. 1, 1994); Reebok Int'l Ltd., 120 F.T.C. 20 (July 18, 1995); and New Balance Athletic Shoe, Inc., 122 F.T.C. 137 (Sept. 10, 1996).

[28] *See* Klein, *supra* note 13, at 433 (concluding that PSKS, Inc., operating as Kay's Kloset, was terminated, not because of a failure to provide services, but solely because it was selling Leegin's handbag line below the minimum prices). It should be noted that Klein is a strong supporter of the use of RPM.

[29] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 916 (2007) (Breyer, J., dissenting) (noting that, despite *Dr. Miles*, we have stores selling complex equipment, "expensive perfume and alligator billfolds" in our economy).

product at a discounted price from a catalog or on-line retailer."[30] But, the brief did not go beyond this single statement on the issue, and the Court's opinion made no reference to it.

B. "Quality certification": free riding on reputation or prestige

"Quality certification" free riding, a variant of the classic free rider theory, posits that a reputable retailer's carrying of an item certifies its quality or stylishness and that free riding occurs when discounters who did not invest to develop this reputation sell to customers who want the product because it has the reputable retailer's stamp of approval.[31] And this is said to deter retailers from investing in quality certification or becoming reputable retailers.[32]

A main weakness of this theory is that most instances of resale price fixing seem to involve established brands, which do not particularly need a prestige retailer's certification.[33] A Sony product, for example, does not need Macy's vote of confidence. Nor does a Vera Wang dress require Neiman's style endorsement. Whether quality certification free riding poses a serious problem and deters investment is probably not a question that can be answered empirically, but there is certainly no evidence of an *under*provision of luxury or quality goods, or of reputable or upscale stores, in our economy.[34] Nor is there indication of a trend among such stores toward business failure or compelled conversion to no-frills or low-prestige retailing.

More importantly, even assuming that quality certification free riding is a major problem that must be controlled, it is difficult to

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[30] Brief for the United States as Amicus Curiae Supporting Petitioner at 13, Leegin Creative Leather Prods., Inc. v. PSKS, Inc, 551 U.S. 877 (2007) (No. 06-480).

[31] Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984).

[32] *Id.*

[33] Even the proponents of the theory acknowledge that there is less need for reliance on retailers for certification "as the manufacturer's brand becomes better known." *Id.* at 349.

[34] *See Leegin*, 551 U.S. at 916 (Breyer, J., dissenting).

imagine minimum resale pricing as an effective remedy. Under the theory, unlike the prestige retailers who have a certification role, nonprestige retailers have *no* service obligations at all. Resale price maintenance agreements would simply give the nonprestige retailers a windfall since they would still be free riding on the prestige retailer's quality certification investment while earning a higher profit margin per unit.[35] In short, the explanation that RPM arrangements are perhaps adopted to prevent certification free riding does not ring true.

As is true for the classic free rider theory, there has been little or no discussion of the effect of the Internet and Internet retailers on this variant explanation for RPM. Intuitively, it seems that the emergence of the Internet further weakens the theory. Given the ease of Internet research and the variety of independent sources of content that is readily available online, the role of the prestige retailer as a quality or style endorser should be much less important today even for the lesser-known brands.

III. IMPACT OF THE INTERNET ON THE FREE RIDER EXPLANATION

The growth of online retailing in the past decade has been remarkable. Because of their lower overhead costs and lower prices, Internet retailers are often portrayed as free riders. The popular perception is that consumers typically visit brick-and-mortar retailers to gather information on a product and consume a salesperson's time, only to subsequently purchase the item from an Internet retailer at a lower price. This free riding narrative is then used to make a case for RPM agreements. It may well be offered as justification by Babies "R" Us, a chain of baby product stores operated by Toys "R" Us, in the pending case alleging that it coerced manufacturers of high-end baby products to institute RPM agreements to stop discounting by Internet retailers.[36]

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[35] An implicit premise of Marvel and McCafferty's theory is that consumers are indifferent as to *where* they purchase a product, so long as it is carried (certified) by a prestigious store. Marvel & McCafferty, *supra* note 31.

[36] *See* McDonough v. Toys "R" Us, Inc., 638 F. Supp. 2d 461 (E.D. Pa. 2009) and BabyAge.com, Inc. v. Toys "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. Pa. 2008).

The following explores how the Internet changes consumer shopping behavior and whether, and how, these changes affect the free rider analysis.

A. Growth of Internet retail and changes to consumer shopping

Online and Internet-influenced offline sales have become increasingly important in retail distribution. Internet sales grew at an average annual rate of 23.1% from 2002 to 2007 while the annual total retail sales growth for the comparable period was only 5%.[37] Between 2006 and 2007, Internet retail sales increased 18.4% as compared to a mere 3.2% gain for total retail sales.[38] As impressive as these figures already are, they do not reflect the full impact of the Internet on the retail market[39] because many more buyers search online retailers' Web sites for price and product information before buying the product at brick-and-mortar stores.[40]

Certain characteristics of the Internet and Internet retailing have caused radical changes in the way many consumers shop,[41] which have a bearing upon free rider issues. A starting point is the wealth of information—such as detailed product features and specifications,

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[37] U.S. CENSUS BUREAU, E-STATS 1, 3 (May 28, 2009), *available at* http://www.census.gov/econ/estats/2007/2007reportfinal.pdf http.

[38] *Id.* at 2, 3.

[39] *See* Yannis Bakos, *The Emerging Landscape for Retail E-Commerce*, 15 J. ECON. PERSPECTIVES 69 (2001) (estimating, through a 2000 study, that purchases aided by the Internet would grow to 10.8% of projected retail sales in 2005).

[40] *See* Gundlach, Cannon & Manning, *supra* note 7, at III.A.1; *Two-Thirds of Consumers Shop Online Before Buying, New Poll Reports*, INTERNET RETAILER, Nov. 7, 2007, http://www.Internetretailer.com/Internet/marketing-conference/73187-two-thirds-consumers-shop-online-before-buying-new-poll-reports.html. Seventy-five percent of those who researched online before shopping at traditional retailers said that online research was the first step they took. *Id.*

[41] *See, e.g.*, Mary Wolfinbarger & Mary C. Gilly, *Shopping Online for Freedom, Control and Even Fun*, 43-2 CAL. MGMT. REV. 34, 34–36 (2000) (discussing attributes of "accessibility/convenience, selection, information, availability and lack of unwanted sociality from retail sales help or shopping partners" of online shopping").

prices, professional product reviews, and user opinions—that can now be found online on practically any product or service. This information is available, not only from online retailers' Web sites, but also from numerous independent online sources such as Epinions.com,[42] Shopper.com,[43] and BizRate.com.[44]

The power of today's search engines enables consumers to effortlessly access and filter this content to find offerings that best match their needs and desires without incurring many transaction costs.[45] They can also learn quickly which retailers have their desired item in stock and at what price.[46] Collecting this type of information before the advent of the Internet would have been impractical for most purchases as it would have involved substantial search costs. For products that consumers are reluctant to buy without first "experiencing" them, this Internet characteristic makes free riding easier and may increase its occurrence. For other products, however, the abundance of content available online may diminish the need for knowledgeable

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[42] *See also* Buzzilions.com, http://www.buzzillions.com/ (last visited Jan. 21, 2009); Consumersearch.com, http://www.consumersearch.com (last visited Jan. 21, 2009); Consumerreports.org, http://www.consumerreports.com (last visited Jan. 21, 2009); ZdNet.com, http://zdnet.com (last visited Jan. 21, 2009); Cnet.com. http://www.Cnet,com (last visited Jan. 21, 2009); Amazon.com, http://www.Amazon.com (last visited Jan. 21, 2009); Google Groups, http://groups.google.com/ (last visited Jan. 21, 2009); Michael R. Baye & John Morgan, *Information Gatekeepers on the Internet and the Competitiveness of Homogenous Product Markets*, 91 AM. ECON. REV. 454 (2001) (discussing some price comparison Web sites).

[43] Shopper.com provides product and price comparison data for particular markets.

[44] BizRate.com provides ratings of Internet retailers.

[45] *See* Bakos, *supra* note 39 (commenting on how search engines help consumers identify seller offerings efficiently); Akshay R. Rao, Mark E. Bergen & Scott Davis, *How to Fight Price War*, HARV. BUS. REV., Mar.–Apr. 2000, at 107 (noting that the Internet makes it easy for consumers to search for and compare prices).

[46] *See, e.g.*, Google Products, http://www.google.com/products (last visited Jan. 21, 2009); Pricegrabber.com, http://www.pricegrabber.com/ (last visited Jan. 21, 2009); Nextag.com, http://www.nextag.com (last visited Jan. 21, 2009); Yahoo! Shopping, http://shopping.yahoo.com (last visited Jan. 21, 2009); Shopzilla.com, http://shopzilla.com (last visited Jan. 21, 2009).

sales assistance and, thus, reduce free riding on brick-and-mortar store services.

Another consumer benefit of Internet retailing (but one not directly related to free riding) is the more expansive product offerings made available to consumers. Online stores can carry much larger selections than brick-and-mortar stores[47] can since they are not constrained by display shelf–space limitations. Amazon.com, for example, is known to carry many more book titles than the approximately 150,000 titles that the largest physical bookstore carries.[48] Moreover, buyers can patronize any online retailer without regard to its geographic "location," which obviously gives them greater selection and options.[49] This is particularly beneficial to buyers with less common needs that are difficult to meet at physical stores.[50] It also benefits consumers living in communities without sufficient population to support a robust local retail market and who would face local monopolies if brick-and-mortar stores were their only option.[51] Yet another beneficial feature of

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[47] *See* Bakos, *supra* note 39.

[48] Judith Chevalier, *Measuring Prices and Price Competition Online: Amazon.com and BarnesandNoble.com*, 1 QUANTITATIVE MARKETING & ECON. 203, 205–06 (2003).

[49] While catalog shopping, which predates the Internet, also has these attributes, the ease of Internet searches and shopping takes the benefits to a different level for Internet customers.

[50] Book collectors who love rare or unusual used books can now go to Abebooks.com, which aggregates almost all second-hand book dealers on the Web, Powells.com, or Bookfinders.com. *See also* Wolfinbarger & Gilly, *supra* note 41 (providing the examples of Oddballshoe.com catering to men with large feet, up to 25 EEEE, and Indiagalore.com offering a wide variety of food and other products that appeal to Indian immigrants). Many other examples abound.

[51] *See* Judith A. Chevalier, *Free Rider Issues and Internet Retailing* 1 (Written Statement to the Federal Trade Commission Public Workshop on Possible Anticompetitive Efforts to Restrict Competition on the Internet, Oct. 10, 2002), *available at* http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/chevalier.pdf (noting that Internet retailing can be expected "to create competition in previously uncompetitive markets"); Wolfinbarger & Gilly, *supra* note 41, at 41 (quoting some consumers on this point, such as: "I live in a very rural area. Other than a Wal-Mart and Kmart, my selection of physical stores is fairly limited"; "I have to drive over an hour to get to anything that resembles a real store"; and "Online is the world's stores in your face.").

online retailing is the unparalleled convenience and control that it offers consumers, who are free to shop any time at home or wherever they have Internet access.[52] To some extent, this convenience factor is also present in catalog shopping but the technology of the Internet magnifies the benefits for online shoppers.

For consumers, price transparency and the relatively lower prices of Internet retailers are also an attraction.[53] Though there are no comprehensive price studies systematically comparing Internet and conventional retail prices, the available data and anecdotal evidence confirm our general sense that Internet prices tend to be lower. For example, a price study of books and CDs conducted in 2000 concluded that online retailers' prices were on average 9%–16% lower than those of brick-and-mortar retailers.[54] Also, according to antitrust complaints recently filed against Babies "R" Us, prices of high-end baby products were substantially lower at Internet stores until Babies "R" Us allegedly coerced manufacturers into instituting minimum resale pricing agreements ending the Internet discounts.[55] That Internet retailers tend to sell at lower prices than brick-and-mortar retailers (absent

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[52] *See* Wolfinbarger & Gilly, *supra* note 41. One commentator also suggested that the Internet shopping experience "encourages dispassionate comparisons of prices and features" leading to buying decisions "based on reason rather than emotion." Indrajit Sinha, *Cost Transparency: The Net's Real Threat to Prices and Brands*, HARV. BUS. REV., Mar.–Apr. 2000, at 43, 48.

[53] *See* Bakos, *supra* note 39 (noting that online retailing "will have more intense price competition," resulting in lower profits as well as lower prices, and citing a source that suggests online shoppers may expect to pay 20%–30% less for items normally priced $30–$500); Erik Brynjolfsson & Michael D. Smith, *Frictionless Commerce? A Comparison of Internet and Conventional Retailers*, 46 MGMT. SCI. 563, 564–65 (2000) (showing prices generally lower on the Internet); Xing Pan, Brian T. Ratchford & Venkatesh Shankar, *Price Dispersion on the Internet: A Review and Directions for Future Research*, J. INTERACTIVE MARKETING, Autumn 2004, at 116, 122, 125 (showing prices at pure online retailers to be generally lower than even the Internet prices at the Web sites of retailers that had a physical presence).

[54] Brynjolfsson & Smith, *supra* note 53, at 563.

[55] *See* McDonough v. Toys "R" Us, 638 F. Supp. 2d 461 (E.D. Pa. 2009); BabyAge.com v. Toys "R" Us, 558 F. Supp. 2d 575 (E.D. Pa. 2008); *see also* Joseph Pereira, *Price-Fixing Makes Comeback After Supreme Court Ruling*, WALL ST. J., Aug. 18, 2008, at A1.

RPM agreements) is unsurprising given Internet retailers' lower overhead costs,[56] which they have an incentive to pass through to buyers in order to increase their own sales and profits. Price transparency provided by the Internet also tends to put downward pressure on the prices of all types of retailers since even consumers who buy from brick-and-mortar retailers often have certain price expectations based on online price checking prior to visiting a store for their purchase.

Finally, online retailers have one drawback that feeds into the popular perception of Internet retailers as free riders. With online shopping, consumers cannot touch, physically examine, or otherwise experience the product through their senses. Nor can they interact with a live salesperson. The significance of this limitation depends greatly on the customer and the type of product in question. Nonetheless, it is often assumed that consumers frequently take advantage of services provided by brick-and-mortar retailers but purchase at a lower price from online retailers, leading to the notion that RPM is needed to discourage free riding. The discussion below analyzes these concerns.

B. Implications of the Internet phenomenon on free riding

As earlier discussed, skepticism toward the free rider explanation for RPM is largely based on the observation that special retailer services vulnerable to free riding are seldom needed to sell most consumer goods, and few retailers provide such services.[57] The classic free rider explanation, therefore, has limited applicability in the real world.[58] Adding online retailing to the mix should not diminish the strength of this critique except at the margins. If specialized retailer services are not needed for the sale of music CDs, jeans, boxed can-

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[56] *See* Rao, Bergen & Davis, *supra* note 45 (suggesting that brick-and-mortar retailers should not try to compete with online vendors on price because they have higher costs than online vendors).

[57] Of course, retailers also offer (and compete on) intangible services, such as extended shopping hours, pleasant décor, and plush surroundings, but intangible services are generally not susceptible to free riding. Customers cannot benefit from one store's pleasant and efficient employees, convenient hours and location, nice ambience, fuller inventory, and generous return policy, for example, while patronizing another store. *See* Lao, *supra* note 19, at 202–03.

[58] For a critique of the free rider explanation for RPM, *see id.*

dies, and the like at brick-and-mortar stores, they should be equally unnecessary when sales are made online. Thus, even in the Internet age, the classic free rider theory is still relevant only in the sale of a relatively narrow group of products. Likewise, the quality-certification free riding explanation is not strengthened by the advent of the Internet. If anything, the wealth of independently created information (e.g., customer reviews, user blogs, professional product reviews) that is available and easily accessible online likely reduces the prestige retailer's importance as a quality or style endorser, even for the less established brands.

1. FOR SENSORY-EXPERIENCE PRODUCTS, FREE RIDING ON BRICK-AND-MORTAR RETAILER SERVICES MAY INCREASE For a subset of products—those for which sensory experience is important to generate sales—the Internet could, however, increase the prevalence of free riding because the Internet eases the task of shopping different stores, and the customer also faces no geographic constraints. To illustrate, a consumer might be reluctant to buy a new facial foundation without first testing it on her skin. For free riding to have occurred before the Internet, she would have had to expend considerable time and effort visiting one no-frills discount store after another in search of the desired brand in the desired shade after she had first tested various brands and shades at a full-service department store. The inconvenience of this effort would have been likely to reduce the occurrence of free riding since, for many consumers, visiting multiple stores would not have been worth it unless the desired product was very expensive and, therefore, the potential cost savings large. Recent marketing research seems to confirm this common-sense reasoning.[59]

The simplicity of Internet searches and online shopping, however, have made free riding less of a chore and less costly. The facial foundation buyer, for example, now has to visit only one brick-and-mortar department store to select the brand and shade that she likes, and then return home to effortlessly search the Internet for the identical item sold at a lower price by an online retailer, without geographic

[59] *See* Paul F. Nunes & Frank V. Cespedes, *The Customer Has Escaped*, Harv. Bus. Rev., Nov. 2003, at 96 ("Just a few years ago, when typical retail shoppers went to a store and received advice on the size, style or purpose of a product, they almost always bought the product right then and there.").

constraints. In light of the relative convenience of this effort, absent RPM, it is reasonable to expect free riding to occur more frequently for sensory-experience products.

2. FOR OTHER PRODUCTS, THE INTERNET MAY REDUCE THE NEED FOR BRICK-AND-MORTAR RETAILER SERVICES AND, THUS, FREE RIDING For other products, however, the Internet may reduce the need for brick-and-mortar store services and, thus, the occurrence of free riding. This is particularly true where the retailer service most in demand is information, since the Internet is a *better* provider of information than the typical salesperson at brick-and-mortar stores.[60] A consumer wishing to buy a GPS system, for example, can almost certainly find much more information on different models and brands online than she can from most sales personnel at brick-and-mortar stores.

The Kindle e-reader, sold only online through Amazon.com, provides an excellent illustration of the capability of the Internet to displace or diminish the previously important role of competent retail salespeople in selling novel or complex information-sensitive products. Since its introduction in late 2007, the Kindle has become quite popular without any live retail sales assistance,[61] despite the fact that it falls into the category of products traditionally considered informa-

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[60] *See, e.g.*, Fiona Scott Morton, Florian Zettelmeyer & Jorge Silva-Risso, *Internet Car Retailing*, 49 J. INDUS. ECON. 501, 502 (2001) ("In addition to being available at close to zero marginal cost, Internet information is of higher quality . . . than information available from offline sources."); Van Baal & Dach, *supra* note 7, at 79 (concluding that the Internet is a more effective source of technical information than traditional stores).

[61] *See* Brad Stone & Motoko Rich, *Turning Page, E-Books Start to Take Hold*, N. Y. TIMES, Dec. 23, 2008, *available at* http://www.nytimes.com/2008/12/24/technology/24kindle.html (stating that because of the popularity of Amazon.com's wireless Kindle device, the e-book has started to take hold); Steven Levy, *The Future of Reading*, NEWSWEEK, Nov. 26, 2007, *available at* http://www.newsweek.com/id/70983; Rick Aristotle Munarriz, *Why Kindle Will Change the World*, THE MOTLEY FOOL, Nov. 27, 2007, http://www.fool.com/investing/general/2007/11/27/why-kindle-will-change-the-world.aspx; and *Shares Surge as Amazon Reports 62% Earnings Rise*, N.Y. TIMES, Oct. 23, 2009, *available at* http://www.nytimes.com/2009/10/23/technology/companies/23amazon.html ("The company declined to give details about sales of its electronic reader, the Kindle, beyond saying it is the company's best-selling product.").

tion- or service-intensive. Instead of having dealer demonstrations, a popular traditional practice for introducing novel and complicated products, Amazon.com prominently displays information on Kindle's full features and specifications on its Web site.[62] The Web site also allows consumers to watch a video showing in detail Kindle's use—a virtual substitute for in-store retailer demonstrations.[63] The online availability of, and easy access to, professional product reviews probably also helped sell Kindle's earliest adopters on the merits of the product, thus minimizing the need for retailers to prime the market. Later adopters have the additional benefit of user reviews. The observations made here of the Kindle are also generally true with respect to most other information-sensitive complex products such as GPS systems and sophisticated digital cameras.

3. FREE RIDING IN REVERSE DIRECTION: BY BRICK-AND-MORTAR RETAILERS ON INTERNET RETAILER SERVICES The sheer amount of information available online on many products and services means that free riding may actually occur, not in the direction usually assumed, but in the *opposite* direction: brick-and-mortar retailers free riding on Internet retailers' services.[64] For example, consumers may browse books and read the associated book reviews on Amazon's user-friendly Web site and then buy the desired book from a neighborhood bookstore.[65] Or buyers in the market for a GPS system may take advantage of an online retailer's well-designed, content-rich, Web site to read all about the features and functionalities of different brands and models, peruse professional product reviews and user opinions, and watch a demonstration video, but ultimately purchase the desired product from a brick-

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[62] *See* Amazon.com, http://www.amazon.com/Kindle-Wireless-Reading-Display-Generation/dp/B0015T963C/ref=amb_link_85978291_2?pf_rd_m=ATVPDKIKX0DER&pf_rd_s=center-1&pf_rd_r=13GJKDJQJXR6MMQ4K37D&pf_rd_t=101&pf_rd_p=498747991&pf_rd_i=507846.

[63] *See* Amazon.com, http://www.amazon.com/gp/mpd/permalink/m3BETPLROS7FKW.

[64] *See* Carlton & Chevalier, *supra* note 7, at 443; Chevalier, *supra* note 51; James V. Koch & Richard J. Cebula, *Price, Quality, and Service on the Internet: Sense and Nonsense*, 20 CONTEMP. ECON. POL'Y 25, 31 (2002).

[65] Chevalier, *supra* note 51.

and-mortar retailer.[66] Consumers may prefer to purchase from a conventional retailer for a number of reasons. They may like the instant gratification of taking immediate possession of a purchased product. Or they may value the peace of mind that comes from buying at a physical store—there are no risks of late or nondelivery or of delivery of a wrong item, and returns are foolproof.

Whatever the reason for many consumers' preference to "research shop" on the Internet but buy the selected product from a brick-and-mortar store, recent marketing research confirms that this is, in fact, the more common direction of free riding today.[67] An IBM-conducted survey of U.S. consumers, for example, found that 78% of the responders had gathered information on the Internet before purchasing from a brick-and-mortar store, while only 8% browsed at a store before buying online.[68] Another study, conducted by Doubleclick, reports similar findings—43% of shoppers reported browsing on the Internet before purchasing at stores, as compared to 16% of shoppers who browsed at stores before purchasing online.[69] A 2007 survey of over 15,000 consumers found that as many as 92.5% of responders reported regularly or occasionally researching products online before purchasing them at brick-and-mortar stores.[70] These and other studies with similar results[71] should cause us to rethink the antitrust approach to free riding and RPM.

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[66] *See* Van Baal & Dach, *supra* note 7, at 81 (showing, in empirical study, that 30.8% of offline purchases involved buyers who had collected information on the Internet before purchasing offline).

[67] *See*, Gundlach, Cannon & Manning, *supra* note 7 (surveying various studies on this issue); Zhang et al., *supra* note 59, at 5.

[68] *See* Zhang et al., *supra* note 59.

[69] *See* Peter C. Verhoef, Scott A. Neslin & Bjorn Vroomen, *Multichannel Customer Management: Understanding the Research-Shopper Phenomenon*, INT'L J. RES. MARKETING 24, 129 (2007).

[70] *See* Gundlach, Cannon & Manning, *supra* note 7, at n.40 (citing News Release, National Retail Federation, RAMA Research Finds Magazines, Television, and Newspapers Prompt Online Product Searches (Mar. 12, 2007)).

[71] *See* Van Baal & Dach, *supra* note 7, at 81 (reporting that about a third of those surveyed collected information online before purchasing offline); Verhoef, Neslin & Vroomen, *supra* note 69, at 129 (finding that research shopping on the Internet before shopping at conventional stores was the most common form of multichannel shopping).

IV. RETHINKING THE RPM RESPONSE

A. Free riding may be synergistic

The term free rider has unfortunately acquired pejorative connotations that conjure up images of slackers unjustly enriched from the efforts of others.[72] This perspective is unnecessarily negative and undesirable. In reality, free riding can sometimes be viewed more favorably as the positive externalities of one actor's activities benefiting another.[73] As such, the effects can be beneficial on balance. As Justice Breyer recognized in his *Leegin* dissent, " 'free riding' often takes place in our economy without any legal effort to stop it," and "[w]e all benefit freely from ideas" from others.[74]

The seemingly counterintuitive notion that free riding can be positive has found some support in marketing research. Some studies show that "a mutually beneficial relationship" often exists among different types of retailers[75] and that competition among them can be complementary, leading to increased total sales.[76] In other words, free riding "across distribution channels" can contribute to channel "synergism" benefiting all concerned.[77] The conventional assumption of

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[72] *See* Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1068 (2005) (discussing and criticizing the tendency to view free riding in this light in intellectual property law).

[73] *See* Lao, *supra* note 19, at 207–08 (criticizing the prevailing overly negative view of free riding and arguing for a more positive view—free riding as a positive externality that can be beneficial on balance).

[74] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 915 (2007) (Breyer, J., dissenting) ("But 'free riding' often takes place in the economy without any legal effort to stop it. Many visitors to California take free rides on the Pacific Coast Highway. We all benefit freely from ideas, such as that of creating the first supermarket. Dealers often take a 'free ride' on investments that others have made in building a product's name and reputation.").

[75] Chip E. Miller, James Reardon & Danny E. McCorkle, *The Effects of Competition on Retail Structure: An Examination of Intratype, Intertype, and Intercategory Competition*, 63 J. MARKETING 107, 107 (1999) (discussing different types of retailers and suggesting that the relationship among them can be symbiotic).

[76] *See* Van Baal & Dach, *supra* note 7, at 76.

[77] *See* Gundlach, Cannon & Manning, *supra* note 7, at III.A.1 & III.A.2.

free riding is that each free rider imposes a cost on the service-providing retailer: the free rider squeezes out a non–free rider and consumes a salesperson's time without giving any value. Marketing studies, however, suggest that this assumption is at least open to question. They show that modest crowds of nonbuyers can actually *benefit*, rather than harm, a brick-and-mortar retailer by stimulating purchases from other consumers.[78] It is not until a store becomes very crowded, and salespeople are too busy to assist potential purchasers, that lower buying results.[79] Stated differently, having a fair number of Internet customers free riding on a brick-and-mortar retailer may result in a net *gain* for the brick-and-mortar retailer, contrary to conventional assumptions.

Similarly, Internet retailers may also benefit from free riders—"research shoppers"[80] who gather information on Internet retailer Web sites but ultimately purchase from a physical store.[81] Consumers who engage in research shopping on Amazon.com's Web site, for example, before purchasing the selected product from a brick-and-mortar store, do not "cost" Amazon.com much, since the marginal cost of an additional user of Amazon's Web content approaches zero.[82] At the same time, the research shopper may create value for Amazon.com by contributing user reviews, making the site more valuable to other customers.[83] In fact, the free riding itself may benefit Amazon.com through the surfing data the consumer leaves behind, which Ama-

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[78] *See* Sevgin Eroglu, Karen Macheleit & Terri Feldman Barr, *Perceived Retail Crowding and Shopping Satisfaction: The Role of Shopping Values*, 58 J. BUS. RES. 1146 (2005).

[79] *See id.*

[80] *See* Verhoef, Neslin & Vroomen, *supra* note 69, at 129 (coining the term "research shopping" for consumers who "research the product in one channel . . . and then purchase it through another channel").

[81] *See* Gundlach, Cannon & Manning, *supra* note 7, at III.C.2.

[82] *See* Carlton & Chevalier, *supra* note 7, at 443 (stating that Internet retailers' costs in providing product-specific product information, customer reviews, photographs and the like on their Web sites are fixed costs).

[83] *See* Vasant Dhar & Elaine A. Chang, *Does Chatter Matter? The Impact of User-Generated Content on Music Sales*, 23 J. INTERACTIVE MARKETING 300 (2009) (showing that consumers place a high value on customer reviews).

zon.com can mine for marketing purposes.[84] Other examples of "cross-channel synergies" abound,[85] suggesting that free riding can be beneficial to all involved.

The positive spillover effects of free riding seen from these studies have implications for antitrust policy toward RPM. If free riding can be synergistic, we should not be so quick to accept the conventional argument that RPM is beneficial because it removes the incentive for free riding. Rather than condone price restraints (albeit intrabrand) to prevent a harm that is exaggerated, it would be helpful to explore ways to encourage retailers in each distribution channel to provide the services that customers using that channel desire most—rather than promoting similar services—and to permit free riding.[86]

B. Ineffectiveness of RPM

Even if one rejects the notion of free riding as synergistic and views it through a more conventional prism, RPM is an ineffective way to induce Internet retailer service for a manufacturer's product.[87] The commonly expressed free riding fear is that customers would visit Babies "R" Us, for example, to inspect a stroller or ask a salesperson to demonstrate its opening and closing, but then buy the product

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[84] *See* Gundlach, Cannon & Manning, *supra* note 7, at V.C.2.

[85] *See id.* at III.D.2 ("For example, the use of mail catalogs is likely to increase traffic at brick-and-mortar channels by providing greater exposure to and identification with the brand among shoppers. Similar outcomes are likely where the use of the Internet increases traffic in retail stores. The use of mail catalogs and the Internet may also result in customers being more informed when they purchase at retail stores, allowing for reduced costs at the point of sale. . . .") (footnotes omitted).

[86] *See* Gundlach, Cannon & Manning, *supra* note 7, at III.E.1 (suggesting that "RPM may have the unintended consequence of increasing channel cannibalization rather than decreasing it" because it tends to result in retailers duplicating each other's services).

[87] For comprehensive critiques of RPM as a brand promotion method, see Warren S. Grimes, *A Dynamic Analysis of Resale Price Maintenance: Inefficient Brand Promotion, Higher Margins, Distorted Choices, and Retarded Retailer Innovation*, 55 ANTITRUST BULL. 101, 110–19 (2010); Robert L. Steiner, *Manufacturers' Promotional Allowances, Free Riders and Vertical Restraints*, 36 ANTITRUST BULL. 383 (1991).

from an Internet retailer that has lower prices. Even assuming that this is a broader phenomenon than recent studies suggest, RPM agreements are simply not useful in inducing Internet retailers to provide the brick-and-mortar retailer service on which they are allegedly free riding. Pure Internet retailers, by definition, are incapable of providing showrooms. While posting photographs of a stroller on their Web sites is possible and often done, creating a physical environment that would allow physical handling of the stroller is impossible. Similarly, while providing a link to a video demonstration is possible, a nonvirtual demonstration of the stroller's operation and features by a live salesperson is impossible. And, while instant communication systems can be set up and often are, Internet retailers cannot entirely replicate the live-salesperson-assistance experience. Because the nature of the services upon which Internet retailers are assumed to be free riding is such that Internet retailers are physically *incapable* of providing them, RPM will not succeed in inducing these services from them.

One might argue that RPM could induce different types of service from Internet retailers—services that they *are* capable of providing, such as detailed product information, photographs, videos, links to professional product reviews and other helpful literature, and customer reviews. There are two responses to that argument. First, there is no evidence that Internet retailers are *not* already providing these services and need to be encouraged to do so.[88] In fact, marketing research shows the opposite to be true: Internet retailers are providing these services and there is substantial free riding on them from "research shoppers" who then buy from brick-and-mortar retailers.[89] Second, the cost structures of providing the two types of service are vastly different.[90] Given the differences, it is inefficient to offer both types of retailers the same compensation through RPM's uniform gross margin, especially when doing so prevents Internet retailers from passing along the benefits of their lower costs to customers.

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[88] A review of any major Internet retailer's Web site shows that these services are provided, and provided well. *See, e.g.*, Amazon.com, http://www.Amazon.com.

[89] *See supra* part III.B.3.

[90] *See* Carlton & Chevalier, *supra* note 7, at 443.

Though research shows that free riding on Internet retailers' services occurs (and is more common than free riding in the reverse direction), it has never been suggested that they need the protection of RPM agreements. Indeed, Internet retailers are usually the strongest opponents of RPM since lower prices constitute one of their competitive advantages over brick-and-mortar retailers, and RPM would eliminate this advantage. Thus, it is unnecessary to discuss whether RPM would induce brick-and-mortar retailers to provide the types of service that Internet retailers usually provide. My focus, instead, has been on the ineffectiveness of RPM in promoting the type of special brick-and-mortar services that Internet retailers generally do not provide—showroom, knowledgeable sales assistance, and the like.

C. *RPM and the overprovision of services*

Assuming the effectiveness of RPM in inducing certain retailer services for some products, there is still the risk of causing an *over*provision of these services. Underlying the free rider justification for RPM are two related assumptions: that consumers uniformly value the retailer services that a manufacturer seeks to induce through RPM and that a manufacturer's choice of service levels and price/service tradeoffs is necessarily socially optimal. The validity of both assumptions is questionable.

1. CONSUMERS MAY NOT UNIFORMLY VALUE SERVICES ENCOURAGED BY RPM Even for products for which free riding can be a problem, not all or even most potential buyers value the services that RPM is supposed to induce.[91] The desire or need for the services often depends on the consumer and other variables. For example, while most people considering the purchase of a *new* perfume would likely wish to try it on first, repeat purchasers have no such need and would probably prefer the opportunity to purchase the perfume at a discount, either online or offline, from a retailer who offers no tester samples or special displays. Similarly, while some buyers of high-end

[91] *See generally* Michael Spence, *Monopoly, Quality, and Regulation*, 6 BELL J. ECON. 417 (1975) (analyzing the effects of differences in consumer preferences for the quality of products); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 991–92 (1984).

televisions or sound systems may want to consult a salesperson or experience the features in a good acoustics room in a brick-and-mortar store, others may prefer to educate themselves through reading detailed product information, professional product reviews, buyer reviews, blogs and other content available online rather than rely on a sales demonstration or a salesperson's advice. RPM agreements preclude retailers from competing with other retailers selling the same product by offering a different price/service package in order to appeal to a different segment of consumers. Rather, customers of a product are treated as homogeneous, and all must pay the RPM price for the additional services regardless of whether they value those services, if they wish to purchase the product.

In fact, under an RPM regime, customers who purchase a product online for convenience, and who do not or cannot enjoy the retailer services that the gross retail margin supposedly encourages, must still pay the higher RPM price. With respect to these customers, RPM agreements do not provide them with any added value but require them to pay more, which results in a transfer of their consumer surplus to the seller. As Justice Breyer noted in his *Leegin* dissent, RPM threatens "wastefully to attract too many resources" into services.[92]

2. MANUFACTURERS' CHOICE OF SERVICES (OR SERVICE LEVELS) REFLECTS PRIVATE EFFICIENCY, BUT NOT NECESSARILY SOCIAL EFFICIENCY Many economists and legal commentators dismiss this argument based on the theory that the interests of manufacturers and consumers are congruent and, therefore, the services (or service levels) implicitly chosen by a manufacturer through RPM must be optimal for consumers as well.[93] The reasoning behind this theory, popularized by Robert Bork, is that it is normally in a manufacturer's best interest to have retailers sell its product at the lowest possible resale price in order to increase sales of

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[92] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 910 (Breyer, J., dissenting).

[93] *See, e.g., Leegin*, 551 U.S. at 896 (majority opinion) ("As a general matter, therefore, 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.' ") (citing Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 74–75 (1998)).

that product.[94] Therefore, if a manufacturer sets an RPM price to induce services, so the argument goes, consumers *must* value the services at least by as much as the amount of the price increase. Otherwise, sales of the product would decrease which would hurt the manufacturer. Knowing that, a manufacturer is unlikely to set resale prices at a level that would result in an overprovision of services.[95]

This theory of congruence of manufacturer and consumer interests, however, has been subject to serious challenge. In a seminal article published in the Harvard Law Review, economist William Comanor persuasively explained that a manufacturer's interest is congruent only with the interests of marginal buyers—those who value the product at approximately the pre-value-added price[96]—who would buy at the higher RPM price only if the value of the services to them exceeds the increase in price.[97] As to these marginal buyers, it is true that there should be no overprovision of services. However, many customers may not need or desire the services but are relatively price-insensitive—the inframarginal buyers—and are willing to pay the higher RPM price for services they either do not value or do not receive. But because they will buy at the higher price, manufacturers do not take their preference for less (or no) special service into account in instituting RPM agreements.[98] With respect to these inframarginal buyers, their interests and that of the manufacturer are clearly *not* congruent.[99]

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[94] *See generally* Robert Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division (pt. 2)*, 75 YALE L.J. 373 (1966). *See also* Mathewson & Winter, *supra* note 93, at 64.

[95] Bork, *supra* note 94, at 403.

[96] I would add to the definition those consumers who would not buy the product at all without the added service.

[97] Comanor, *supra* note 91, at 991–92; *see also* Spence, *supra* note 91.

[98] Comanor, *supra* note 91, at 991–92.

[99] Of course, the same is also true for manufacturer advertising and any other promotional method used by the manufacturer. An inframarginal consumer who already knows that she wants a specific product and does not benefit from the manufacturer advertising would, in fact, be paying more for a service that she does not value. The point I make here is simply that we cannot assume the congruence of the interests of a manufacturer and consumers and proceed to further assume little divergence between private and social efficiency.

From the standpoint of social welfare, RPM would not be socially efficient if those who do not value the services (but are relatively price-insensitive and will continue to buy at the RPM price) substantially outnumber those who value them.[100] It would foist services on segments of customers who do not desire them. Even worse, in the case of Internet purchases, inframarginal buyers would be asked to pay a higher price for services that they do not even receive, resulting in a transfer of consumer surplus from buyers to sellers.

As to why private and social efficiency might diverge, there are a few possible reasons. First, in a market with substantial brand differentiation, a brand may be insulated from interbrand competition to a certain extent, giving the manufacturer some degree of power to raise prices even in a relatively competitive market. Thus, a manufacturer may use RPM primarily as a way to jointly maximize its profits and that of its retailers (to be shared between them), resulting in little net gain in services for consumers.[101] Second, RPM may reflect oligopoly pricing—which is not itself illegal—if it is adopted by most of the major manufacturers in the market.[102] In this situation, RPM would also result in higher consumer prices with little or no net gain in consumer services. Third, Warren Grimes has argued that RPM can be used as a price-signaling device to indicate quality and, when it is so used, the higher RPM price does not reflect net gain in services.[103]

Manufacturers, unsurprisingly, tend to focus on *private* efficiency, not social efficiency, in deciding whether to induce services through

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[100] *See* Comanor, *supra* note 91, at 991 ("[S]ocietal gains or losses from changes in the product depend on the preferences of *all* consumers, not merely those at the margin. To the extent that [the additional services] fail to reflect the preferences of infra-marginal consumers, the interests of consumers in general may not be served."); Spence, *supra* note 91, at 417–22.

[101] *See* Marina Lao, *Resale Price Maintenance: A Reassessment of Its Competitive Harms and Benefits*, *in* MORE COMMON GROUND FOR INTERNATIONAL COMPETITION LAW (Josef Drexl et al., eds., 2010) (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1434984.

[102] *See* Richard M. Brunell, *Overruling* Dr. Miles*: The Supreme Trade Commission in Action*, 52 ANTITRUST BULL. 475, 500–01 (2007).

[103] *See* Warren S. Grimes, *The Path Forward After* Leegin*: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, 75 ANTITRUST L.J. 467, 484 (2008).

RPM. A practice is privately efficient for manufacturers so long as it produces a net profit for them, even if the profits come mostly from consumer surplus (in which event it may not be socially efficient).[104] Thus, the fact that a manufacturer has implicitly chosen a certain level of services through RPM means only that the choice is privately optimal for the manufacturer. It does not necessarily mean that the services or service levels chosen are socially efficient.

V. ALTERNATIVES TO RPM

It is a widely accepted tenet of American antitrust jurisprudence that, even if a trade restraint has a legitimate business justification, it can still be prohibited if there are alternative methods of achieving the objective that are less restrictive of competition. Since there is consensus that RPM can potentially reduce competition and harm consumers,[105] and some argue that the risk of harm is substantial,[106]

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[104] *See* Comanor, *supra* note 91, at 991 ("If marginal consumers value the extra services more than their cost—and increase their purchases of the product—the manufacturer will find it profitable to impose restraints that increase the volume of their services regardless of the preferences of infra-marginal consumers.").

[105] *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 892–93 (2007) (recognizing that RPM agreements can be used anticompetitively to facilitate a cartel or otherwise stabilize prices at either the manufacturer or dealer level, and that, even without concerted action, they can be anticompetitive if they result from pressure from a dominant dealer, or are imposed by one or more powerful manufacturers acting alone).

[106] *See, e.g.*, An Open Letter to the Supreme Court of the United States from Commissioner Pamela Jones Harbour (Feb. 26, 2007), *available at* http://www.ftc.gov/speeches/harbour/070226verticalminimumpricefixing.pdf; Pitofsky, *supra* note 22; Brunell, *supra* note 102; Grimes, *supra* note 103; Brief of the American Antitrust Institute as Amicus Curiae in Support of Respondent, *Leegin*, 551 U.S. 877 (No. 06-480). The State Attorneys General of thirty-eight states have submitted to Congress joint letters, dated October 27, 2009, strongly supporting the passage of S. 148 and H.R. 3190, the Discount Pricing Consumer Protection Act, which would repeal *Leegin*. *See* Letter from Thirty-Eight State Attorneys General to Sen. Herb Kohl and Sen. Orrin G. Hatch (Oct. 27, 2009), *available at* http://naag.org/assets/files /pdf/signons /20091027.S_148.pdf; Letter from Thirty-Eight Attorneys General to Rep. John Conyers and Rep. Lamar Smith (Oct. 27, 2009), *available at* http://naag.org /assets/files/pdf/signons/20091027.HR_3190.pdf [hereinafter Letters of the States].

addressing possible alternatives less restrictive of competition is imperative.

A. Promotional allowances

1. MORE EFFECTIVE AND EFFICIENT THAN RPM Consumers have clearly embraced the Internet and integrated it into their shopping behavior by shopping "across channels." Many seemingly enjoy browsing on Internet sites and then buying from a brick-and-mortar store. Some—apparently a smaller percentage—browse at brick-and-mortar stores and then buy online. Since Internet and brick-and-mortar retailers provide very different types of services for a manufacturer, direct and separate promotional allowances paid to them for their services should be more effective and efficient than RPM. Promotional allowances can be targeted toward the actual services provided,[107] as contrasted with RPM, which gives the same gross margin to *all* retailers regardless of the types (and costs) of services that they provide.

With promotional allowances, the *manufacturer* is in fact paying for the services, not the retailers, and there is thus no true free riding no matter how consumers choose to shop.[108] Stated differently, if a manufacturer compensates a brick-and-mortar retailer for providing a showroom and competent demonstrations of its products, Internet retailers are not really free-riding when they sell to consumers who took advantage of these brick-and-mortar store services. And there should be minimal disincentive effect on the brick-and-mortar retailers' willingness to provide the services since they have been compen-

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[107] *See* Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 101 (1995). *See also* Steiner, *supra* note 87 (arguing strongly that promotional allowances, not resale price maintenance agreements, would better promote dealer services).

[108] *See* Toys "R" Us v. Fed. Trade Comm'n, 221 F.3d 928, 938 (7th Cir. 2000) (concluding that where Toys "R" Us received separate compensation from the toy manufacturers for performing various retailer services, "there was little or no opportunity to 'free' ride on anything"; because the manufacturer was paying for the services, the services were not "susceptible to free riding").

sated. Similarly, if Internet retailers are compensated for their costs of generating information on a manufacturer's brand and posting on their sites, it would not be free riding if some buyers of a GPS, for example, reviewed an online retailer's Web content prior to buying the system from a brick-and-mortar store.

Promotional allowances permit a manufacturer to distinguish between the different types of services provided by Internet and brick-and-mortar retailers, and to compensate them accordingly. This would allow consumers, who are heterogeneous, to shop in the manner that suits them—whether it is browsing online and buying from a brick-and-mortar retailer, or browsing at a brick-and-mortar retailer and buying online, or staying with one store from start to finish.

Of course, no matter which promotional method is used, the consumer eventually pays the costs. With promotional allowances, the manufacturer would likely factor them into its costs, which would be reflected in higher wholesale prices and ultimately higher retail prices. With RPM, the guaranteed higher gross retail margin given to all retailers results in higher retail prices. But, in addition to being better targeted toward the retailer services provided, promotional allowances have the added advantage of permitting intrabrand price competition, which RPM prohibits. Allowing retailers to discount preserves their incentives to improve efficiencies and to develop innovative ways of retailing that would provide services in the most cost-effective way.

Moreover, as previously discussed and contrary to common assumptions, current market research suggests that free riding can benefit rather than harm consumer welfare in various ways.[109] It can create "cross-channel" synergies benefiting all, rather than simply inflict costs on and give no value to the service-providing retailer. The research shows, for example, that consumers visiting a brick-and-mortar store to see a product before buying it online do not add to the store's costs of providing the services unless the number of consumers doing so is excessive.[110] In fact, modest crowds at stores can stimulate purchases by *other* customers, though the free riders them-

[109] *See supra* part IV.A.

[110] *See* Gundlach, Cannon & Manning, *supra* note 7, at V.C.1.

selves make no purchases.[111] Thus, a moderate amount of free riding by Internet customers can actually result in a net *benefit* to brick-and-mortar retailers. Studies also suggest that Internet use does not necessarily cannibalize brick-and-mortar sales of a product but can increase customer traffic in brick-and-mortar stores, presumably because Internet use gives greater exposure to the brand.[112]

Internet retailers may also benefit from free riders—those who collect information from Internet retailer sites but buy from brick-and-mortar stores. Because of the types of service they provide, the Internet retailers' costs normally do not increase with each additional user.[113] Once content on a product is generated (e.g., description of its features and specifications, photographs, videos, links to professional product reviews, and a forum for customer reviews), even a large number of free riders accessing this information would not add to the Internet retailer's costs. Moreover, these free riders may potentially create value for the online retailer by returning to the online retailer's site to write a review.[114] Since research shows that consumers highly value consumer reviews, the free riders' user opinions would enhance the attractiveness of the Internet retailer's Web site to other potential customers.[115] Additionally, the online retailer can mine data left behind on its site by the free rider's surfing for useful information on shopping patterns.[116]

2. CONTRARY ARGUMENTS Supporters of RPM have rejected the notion that promotional allowances are at least as effective and efficient as RPM. One argument, made by Klein, is that a system of rewarding retailers based on actual *sales* and not on the services (i.e., RPM) is a greater incentive to retailers to provide the desired

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111 *See* Eroglu, Macheleit & Barr, *supra* note 78.

112 *See* Gary L. Frazer, *Organizing and Managing Channels of Distribution*, 27 J. ACAD. MARKETING SCI. 226, 232 (1999) (showing that mail catalogs tend to increase traffic at retail stores); Gundlach, Manning & Cannon, *supra* note 7, at III.A.1 (suggesting that the same result is likely with Internet browsing).

113 *See* Carlton & Chevalier, *supra* note 7, at 443.

114 *See* Gundlach, Manning & Cannon, *supra* note 7, at III.C.2.

115 *See id.*

116 *See id.*

services.[117] There are two responses to that argument. First, it is not self-evident that linking payment to per unit sales rather than to effort is more efficient. It is difficult to see why providing the same margin to Internet and brick-and-mortar retailers (i.e., RPM) when they provide such different types of service—and incur very different costs—would be efficient. If the concern is that retailers would become lax if they receive payment for service without any reference to the number of units sold, the better solution would be to monitor and police the service expectations underlying the promotional allowance. Second, Warren Grimes has argued that promotional allowances do not have to be based on services provided but, just like RPM, can be pegged to per unit sales.[118]

Another argument that has been asserted against promotional allowances runs in the opposite direction. It assumes, unlike Klein, that promotional allowances *should* reward retailers for their actual sales efforts but suggests that it is difficult to do so with fixed fees for brick-and-mortar retailers.[119] This critique seems to be that, because the costs of providing the services vary with the number of visitors to the store and the time spent per visitor, it is difficult to devise a compensation formula that would accurately reflect the costs actually incurred by the retailer in promoting the manufacturer's products.[120] This objection to promotional allowances is also unpersuasive. While the assertion that accurate cost measurement is difficult is indeed correct, fixed payments do not have to be based on precise mathematical calculations to be effective in encouraging services. RPM agreements, after all, also do not compensate retailers for the precise costs of providing their services to customers: retailers under RPM may also be overpaid or underpaid depending on the number of customers served, the amount of attention each customer required, the number of sales made, and various other factors.

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[117] Klein, *supra* note 13, at 453–55.

[118] Grimes, *supra* note 87, at 133.

[119] Chevalier, *supra* note 51.

[120] *See id.* at 2 ("However, it would be very difficult to enforce a contract in which a manufacturer compensated a brick-and-mortar retailer for every minute of time that the retailer spent demonstrating the manufacturer's product for a customer.").

A third argument asserting the relative inefficiency of promotional allowances contends that they are more difficult and costly to monitor than RPM agreements.[121] However, those who take this view seem to focus on the ease of *detecting discounting* in the case of RPM as compared to the difficulty of ensuring retailer performance of its special service obligations in the case of promotional allowances.[122] Ensuring that there is no surreptitious retail discounting under RPM is no doubt easier and less costly than monitoring retailer provision of services for which a promotional allowance is given. But those are *not* the proper costs for comparison. Just as a retailer receiving a promotional allowance may simply pocket the allowance and free ride on another retailer's services, so too can a retailer receiving an RPM margin ignore the manufacturer's service expectations, keep the margin, and free ride on other retailers. Thus, what the manufacturer must monitor in *both* situations is the provision of services: whether a retailer is providing the services that the RPM retail margin was intended to encourage (and not merely whether it is discounting) in the case of RPM; and whether a retailer is providing the services for which it is receiving compensation, in the case of a promotional allowance. And it is difficult to see how the costs of policing the retailers' service obligations in the two scenarios could be any different.

Finally, some RPM supporters seem to simply assume that if a manufacturer chooses RPM over promotional allowances to induce services, RPM *must* be the more efficient strategy. This assumption, however, is valid only if the manufacturer's *private* efficiency, rather than *social* efficiency, is the appropriate measure of efficiency in antitrust law.[123] If a manufacturer institutes RPM agreements on its own initiative, we can safely assume that the strategy must be pri-

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[121] *See* Bowman, *supra* note 16; Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); BORK, *supra* note 6, at 291; Ippolito, *supra* note 6; Lester Telser, *Why Should Manufacturers Want Fair Trade II?*, 33 J.L. & ECON. 409 (1990).

[122] *See, e.g.*, Telser, *supra* note 6, at 94 ("[I]t is easier to police violations of minimum prices than to survey retailers to see that they do indeed provide the special services and do not simply fritter away the direct payments.").

[123] *See* Lao, *supra* note 101 (arguing that various procompetitive theories of RPM demonstrate private efficiency but do not necessarily demonstrate social efficiency and that antitrust law should be concerned with the latter).

vately efficient for the manufacturer (unless the manufacturer made an erroneous judgment). But a manufacturer's private efficiency is not necessarily equivalent to social efficiency because, as earlier discussed, the interests of manufacturers and consumers are only sometimes congruent.

B. *Limited distribution*[124] *(excluding Internet) and choosing an appropriate mix of retailers*

For products that few consumers would consider purchasing without first visiting a store (e.g., expensive brands of major appliances), Internet free riding on brick-and-mortar retailer services may be substantial. In that case, a manufacturer's selling exclusively through brick-and-mortar retailers may be a more effective and efficient alternative. Despite the fact that this nonprice restraint excludes Internet distribution entirely while RPM does not, it is likely to be less threatening to competition than RPM for two reasons. If few consumers would contemplate purchasing a particular product sight unseen in the first place, the unavailability of the product online would have little adverse effect on consumer convenience and choice. More importantly, there is a built-in deterrence to manufacturers' overuse of this distribution restriction. Because Internet shopping is becoming increasingly popular, confining sales to brick-and-mortar stores is not a decision that manufacturers would lightly make. Thus, there is probably a self-imposed restriction on its use to those instances where free riding by Internet retailers would be a significant concern. This type of limited distribution would also be more effective in preventing free riding than RPM: if the product is unavailable on the Internet, free riding by Internet retailers on services provided by brick-and-mortar retailers is simply impossible.

As among the brick-and-mortar retailers, manufacturers can minimize the possibility of free riding by being selective in their choice of retailers. They can choose only specialty retailers who follow a service-intensive business model and avoid those who tend toward self-service. Or they can select a mix of retailers offering varying levels of

[124] For an analysis of why RPM generally carries greater anticompetitive risks and offers fewer potential consumer benefits than limited distribution, see Grimes, *supra* note 87, at 130–33.

service, as long as the low-service stores are located at a sufficient distance from the high-service stores to reduce free riding. For instance, a manufacturer of high-end large appliances—which consumers typically wish to see before buying—may choose to distribute only through service-intensive specialty stores. Or it may include some no-frills or fewer-frills stores located farther away, perhaps in an outlet mall, to provide more options for those customers who wish to see the product before purchase but do not need much attention. So long as the stores providing different service levels are located far enough apart to make free riding inconvenient for those who *do* require or desire the services, this nonprice restraint could be less restrictive of competition than RPM and would provide more choice to consumers.

VI. GOING FORWARD

Those with less familiarity with antitrust litigation may be puzzled by the controversy surrounding *Leegin* since opponents of the decision generally agree that RPM is sometimes procompetitive[125] (just as the *Leegin* majority and its supporters also recognize that the practice can be anticompetitive).[126] After all, on its face, *Leegin* merely endorses a rule of reason and does not declare RPM per se *lawful*. If there is consensus in the economic literature that RPM may have procompetitive uses, why not adopt a standard that looks at all factors relating to the restraint to determine its reasonableness?

The answer is that the full rule of reason, in reality, usually operates as a de facto *legality* rule. Posner has described the rule of reason as "in practice . . . no more than a euphemism for nonliability."[127] Judge Douglas Ginsburg of the D.C. Circuit Court of Appeals, a former assistant attorney general in charge of the Antitrust Division of the Department of Justice in the Reagan administration, has likewise characterized the rule as one of de facto legality.[128] Other commenta-

[125] *See, e.g.*, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 915 (2007) (Breyer, J., dissenting).

[126] *See, e.g., id.* at 891–908 (majority opinion).

[127] Posner, *supra* note 4, at 14.

[128] Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67, 71 (1991).

tors have made similar observations, portraying it as presenting "a defendant's paradise,"[129] or as "a euphemism for endless economic inquiry resulting in a defense verdict."[130]

This common knowledge about the realities of antitrust litigation is confirmed by actual data. Ginsburg's conclusion that the rule of reason is effectively a per se legality rule was based on his review of all forty-five vertical nonprice restraint cases brought between 1977 (after *Sylvania*) and 1991, and finding that plaintiffs lost forty-one, over ninety percent.[131] More recently, Michael Carrier examined all 222 rule of reason cases that reached final judgment in the last decade and found that defendants won 221, or 99.6%.[132] Another study likewise concluded that, after the rule of reason was adopted for maximum vertical price fixing in *Khan*, the practice became "de facto legal."[133]

Though these results admittedly do not prove it, their extreme lopsidedness makes it unlikely that they merely reflect a substantive lack of merit in virtually all the cases. Instead, the overwhelming number of defense verdicts is more likely attributable to the formidable, and widely acknowledged, problems of proof of a defendant's market power, which must be proven in rule of reason cases.[134] Breyer noted as much in his *Leegin* dissent when he stated: "The Court's invitation to consider the existence of 'market power' . . . invites lengthy time-con-

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[129] Stephen Calkins, California Dental Association: *Not a Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495, 521 (1999).

[130] Maxwell M. Blecher, Schwinn—*An Example of Genuine Commitment to Antitrust Law*, 44 ANTITRUST L.J. 550, 553 (1975).

[131] Ginsburg, *supra* note 128, at 71. Three of the four plaintiff victories involved defendants with significant market power, leading Ginsburg to say that "non-monopolists have been effectively freed from antitrust litigation" under the rule of reason. *Id.*

[132] Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 829 (2009). The one plaintiff victory was won by the government in *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003).

[133] Daniel A. Crane, *Chicago, Post-Chicago, and Neo-Chicago*, 76 U. CHI. L. REV. 4 (2009).

[134] *See* 8 AREEDA & HOVENKAMP, *supra* note 19, ¶ 1620.1 at 317 (2008 Supp.) ("One of the biggest hurdles for future RPM plaintiffs is likely to be the market power requirement.").

suming argument among competing experts, as they seek to apply abstract, highly technical, criteria to often ill-defined markets."[135] Indeed, several post-*Leegin* RPM cases have already been dismissed on the pleadings for failure to properly allege a relevant market.[136]

Adopting a rule that would effectively treat RPM as de facto legal would be unwise since RPM agreements have substantial economic dangers,[137] particularly with the emergence of Internet retailing. Few people would deny the dramatic benefits that the Internet and online retailers have provided consumers. RPM agreements can impede the growth of this vibrant retail sector by taking away one of its core competitive strengths[138]—the ability to offer lower prices to customers who do not highly value the types of services that brick-and-mortar stores uniquely provide.

For the same reasons that a full rule of reason is problematic, any formulation of the rule that effectively makes the same demands of all or almost all RPM plaintiffs is equally unworkable and undesirable. For example, the "structured" rule of reason approach recently outlined by Christine Varney,[139] Assistant Attorney General in charge of

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[135] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 917 (Breyer, J., dissenting).

[136] On remand in *Leegin*, the lower court allowed plaintiff to file an amended complaint but then dismissed it, on defendant's motion to dismiss, on grounds that the relevant market alleged was too narrow as a matter of law. PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 2009 WL 938561 (E.D. Tex. 2009). *See also* Spahr v. Leegin Creative Leather Prods., Inc., 2008 WL 3914461 (E.D. Tenn. 2008); Jacobs v. Tempur-pedic Int'l, Inc., 2007 WL 4373980 (N.D. Ga. 2007). *But see* BabyAge.com v. Babies "R" Us, Inc., 558 F. Supp. 2d 575 (E.D. Pa. 2008) (denying motion to dismiss).

[137] Even the *Leegin* majority, for example, recognized that RPM may have anticompetitive effects and took pains to admonish lower courts to recognize, and prohibit, its anticompetitive uses. *See Leegin*, 551 U.S. at 896–97.

[138] *See generally* Lao, *supra* note 101, at part 3.1.2 (contending that RPM minimizes the incentive for retail innovation); Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L.J. 407 (1997) (emphasizing RPM's potential to inhibit retail innovations).

[139] Christine A. Varney, *A Post-*Leegin *Approach to Resale Price Maintenance Using a Structured Rule of Reason*, 24 ANTITRUST 22 (2010).

the Antitrust Division of the Department of Justice, essentially elaborates on the kinds of evidence that plaintiffs should produce to satisfy a full rule of reason analysis, depending on which of four anticompetitive theories underlies the plaintiff's case.[140] The approach appears to be almost as, if not equally, burdensome on plaintiffs as a full rule of reason test[141] and, thus, is not truly an improvement.[142]

At the same time, the *Dr. Miles* per se rule may be too inflexible since there is economic consensus that RPM can be effective in promoting a manufacturer's brand, leading to increased sales or output (though there is no consensus that it is the most efficient and procompetitive way of achieving these ends). Many commentators and regulators have already put forth various detailed proposals for the appropriate treatment of RPM post-*Leegin*.[143] My objective in this arti-

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[140] *See id.* at 24–25.

[141] For example, to establish a prima facie case under a manufacturer exclusion theory, plaintiffs must show 1) manufacturer's dominant market position; 2) manufacturer's RPM contracts covered enough outlets to "result in material foreclosure"; and 3) "RPM plausibly has a significant foreclosure effect." In other words, not only must plaintiffs show the manufacturer has substantial market power, it must identify "at least one particular foreclosed rival." *See id.* at 24. The requirements for making out a prima facie case under the three other anticompetitive theories discussed are equally demanding—they all require showing substantial market power either on the part of the manufacturer or a retailer. *See id.* at 24–25.

[142] Likewise, Thomas Lambert's "decision-theoretic rule of reason" would likely result in defense verdicts in almost all RPM cases. Lambert's rule is arguably even more difficult for plaintiffs than a full rule of reason. It would require "convincing evidence" of "output reduction that cannot be attributed to" non-RPM causes or, alternatively, proof of "the existence of all the prerequisites to one of RPM's anticompetitive harms" and then rebuttal of any claim that "RPM was imposed as the most efficient means of securing a procompetitive end." Lambert himself acknowledges that "[f]ew challenges to instances of minimum RPM will succeed" under his proposed rule. *See* Thomas A. Lambert, *A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance*, 55 ANTITRUST BULL. 167, 214–24 (2010).

[143] *See, e.g.*, Varney, *supra* note 139; Lambert, *supra* note 142; John B. Kirkwood, *Rethinking Antitrust Policy Toward RPM*, in this issue of the *Antitrust Bulletin*; Grimes, *supra* note 103, at 492; Brief for the American Antitrust Institute as Amicus Curiae in Support of Appellant and Reversal, PSKS, Inc. v. Leegin Creative Leather Prods., Inc. (5th Cir. 2009) (No. 09-40506) [hereinafter

cle is not to engage in an evaluation of each of these proposals, or to present my own detailed alternative.[144] Rather, I would simply suggest a rebuttable presumption of illegality approach—a simpler and more structured form of the quick-look rule of reason that is commonly applied in modern horizontal restraint cases[145]—following the *Polygram* framework.[146]

A rebuttable presumption of illegality analysis would strike a good balance between the need to afford plaintiffs a realistic chance of proving that an RPM agreement is anticompetitive and the countervailing need to allow defendants the opportunity to justify its use in a particular case. This would preserve the incentives of Internet retailers to continue developing innovative ways to perform their retailing functions and provide services to consumers in the most efficient way.

AAI Brief]; Brief for Comanor and Scherer, *supra* note 19; Amended States' Comments Urging Denial of Nine West's Petition, *In re* Nine West Group, Inc., No. C-3937 (F.T.C. Apr. 11, 2000), *available at* http://www.oag.state.ny.us/business/new_antitrust/amici%20pdf%20docs/Amended_State_comments_011708-9west.pdf; Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, *In re* Nine West Group, Inc., No. C-3937 (F.T.C. May 6, 2008), at 11–14; Lao, *Free Riding*, *supra* note 19, at 215–16.

[144] For two very different critiques of various proposed rules, see Kirkwood, *supra* note 143, at part III; Lambert, *supra* note 142, at 194.

[145] *See, e.g.*, Nat'l Soc'y of Prof'l Eng'rs v. FTC, 435 U.S. 679 (1978); NCAA v. Board of Regents, 468 U.S. 85 (1984); FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1987). In all three cases, the Court applied what later became known as the quick-look rule of reason. In none of these cases did the Court insist on an elaborate, formal, market analysis—delineating the relevant market and then proving defendant's market power.

[146] Polygram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005). *See also* AAI Brief, *supra* note 143; Kirkwood, *supra* note 143. To rebut the presumption of illegality, a defendant could perhaps come forward with evidence showing that it has insubstantial market power in the relevant market and that its action was voluntary and not coerced by retailers. Or it might show that it is a new entrant to the relevant market whose RPM agreements are unlikely to have anticompetitive effects. Or, in a case where Internet retailers are involved, it could establish that the product is the type that few consumers would buy without first visiting a store; thus, free riding on brick-and-mortar store services by Internet retailers is likely to be rampant, and alternative ways of controlling these free riding problems are less effective and less efficient than RPM.

VII. CONCLUSION

The remarkable growth of Internet retailing in the past decade, along with the powerful capabilities of the Internet, has substantially changed the way many consumers shop. Yet, the theoretical analysis of RPM and free rider issues has largely overlooked this phenomenon. This article has taken a closer look at Internet retailing and the issues it raises pertaining to the free rider justification often asserted for RPM. I conclude that the case in support of RPM as a means of controlling free rider problems is not strengthened by the advent of Internet retailers. While the Internet may increase the occurrence of free riding for some products, it may also reduce it for others. In fact, recent marketing studies tend to dispel the popular perceptions that Internet retailers are frequent free riders and that free riding is necessarily harmful. These new insights call into question the general assumption that free riding must be discouraged.

Even if we look at free riding from a conventional perspective, RPM may not be the most effective way to induce retailer services, or it may induce an excessive amount of certain kinds of services. In view of the many benefits of Internet retailing, antitrust law should disfavor a trade restraint that inhibits its development and growth, such as RPM, if there are alternative means of promoting retailer services that do not present a similar risk. Promotional allowances (and, in limited circumstances, restrictive distribution excluding Internet sales) could be such alternatives.

Since there is consensus that RPM can be anticompetitive, a full rule of reason (or other comparable formulation) is unworkable since it is effectively a de facto legality rule. Rather, a rebuttable presumption of illegality would provide an appropriate legal framework for taking into account the risks of anticompetitive harm as well as the possibility of procompetitive benefits.