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Client Alert

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New Standard for Evaluating Minimum Resale Price Agreements Under Antitrust Law

On June 28, 2007, the US Supreme Court issued its opinion in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the last of four antitrust cases decided this Term.[1] The Court in *Leegin* overruled a 96-year-old precedent, and held that an agreement between a manufacturer and its distributor to set minimum resale prices should now be judged based on its reasonableness, rather than being deemed *per se* unlawful. The Court's opinion changes the legal landscape under federal law for evaluating the legality of minimum resale price agreements. The degree to which state antitrust laws follow suit remains to be seen.

This *Client Alert* briefly summarizes the *Leegin* decision and its key take-aways.

> "The Court's opinion changes the legal landscape under federal law for evaluating the legality of minimum resale price agreements."

Summary of *Leegin*

On its facts, Leegin is a common resale price maintenance case in a terminated dealer context. Plaintiff PSKS operates Kay's Kloset, a women's apparel store in Texas. Defendant *Leegin* manufactures and distributes leather goods and accessories, including leather belts sold under the brand name "Brighton." Leegin believes that, for some of its products, smaller retailers provide better customer service and a more satisfactory shopping experience than larger, more impersonal stores. In 1997, Leegin established a minimum resale price policy pursuant to which Leegin refused to sell to retailers that sold Brighton products below Leegin's suggested prices. Leegin believed this price policy would give its retailers the incentive to provide superb customer service and support for its Brighton products. When Leegin discovered that PSKS's store was discounting its Brighton products by 20 percent below its suggested prices, Leegin stopped selling to the store.

PSKS filed a federal lawsuit, alleging that Leegin's agreements with retailers to charge prices at or above levels set by Leegin violated federal antitrust law. The trial court found Leegin's minimum resale price policies per se illegal under the rule established by the Supreme Court decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[2] It rejected expert testimony that Leegin's price policy was procompetitive on the ground that, under *Dr. Miles*, the policies were per se illegal and therefore no such testimony was relevant. The US Court of Appeals for the Fifth Circuit agreed.[3]

The Supreme Court granted certiorari to decide whether to retain the *Dr. Miles* rule making minimum resale price maintenance agreements *per se* illegal.

In an opinion authored by Justice Kennedy, the Court overruled *Dr. Miles* by a 5-4 vote. The Court first recognized that antitrust principles require most agreements to be evaluated under the "rule of reason," which looks to the agreement's actual marketplace

effects and condemns agreements only when they "unreasonably" restrain competition. By contrast, certain agreements are condemned as *per se* illegal, which "eliminates the need to study the reasonableness of an individual restraint in light of the real market forces at work."[4] But while *per se* rules provide clarity, the Court warned that they are to be reserved for restraints that have "'manifestly anticompetitive' effects, … and 'lack … any redeeming virtue.'"[5]

With respect to minimum resale price agreements, the Court observed that its subsequent antitrust precedents had undermined the original rationales for *per se* treatment of resale price maintenance claims. It found that "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[6] The Court also found that, like other vertical restraints recently liberated from the per se rule and placed in the rule of reason category, "minimum resale price maintenance can stimulate interbrand competition — the competition among manufacturers selling different brands of the same type of product — by reducing intrabrand competition — the competition among retailers selling the same brand."[7] The Court acknowledged that such agreements can also be anticompetitive, but held that minimum resale price agreements can have sufficient procompetitive effect that courts should evaluate them as to whether they are reasonable.[8]

Navigating Resale Price Agreements After *Leegin*

The opinions in Leegin offer some guidance on both attacking and defending minimum resale price policies under the new rule of reason standard. This guidance comes from both Justice Kennedy's majority opinion and Justice Breyer's dissent, which contain examples of procompetitive and anticompetitive resale price maintenance.

Attacking Minimum Resale Price Policies After *Leegin*

First, the Justices suggested that courts will still invalidate resale price maintenance in cases alleging a dealer or manufacturer cartel (which the Court says still "is and ought to be" *per se* illegal[9]); indeed, the Court noted that the prevalence of minimum resale price maintenance policies may be "useful evidence" of the existence of a cartel.[10] Creative plaintiffs may attempt to cast horizontal suspicions on cases that initially appear only to be vertical in order to invoke the *per se* rule for horizontal restraints.

Second, for purely vertical cases, the Court recognizes that, if either level of the distribution chain had market power,[11] the potential for anticompetitive effects increases. The Court warned that "a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes" if it has market power. A dominant retailer might coerce a manufacturer to establish a resale price maintenance policy "to forestall innovation in distribution that decreases costs."[12] And, a dominant manufacturer "might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants."[13] In all cases, the "uniformity of the practice" will be a key point in the proof.[14]

Third, the Court pointed to the source of the resale price agreement as an appropriate inquiry. Where the minimum resale price policy originates from a retailer, rather than the supplier, that may be an indication of cartel activity at the retailer level, or the efforts of a dominant retailer to maintain resale prices.

It should also be noted that the Court invited further development of rule of reason analysis for minimum resale price maintenance, "to establish the litigation structure … to provide more guidance to businesses," and even to "devise

rules over time for offering proof, or even presumptions where justified."[15] This may lead to additional bases for attacking resale price maintenance practices. The Court, however, declined to address the presumptions advocated by a number of amici curiae, leaving it to the lower courts to create new analytic rules as they go.

Defending Minimum Resale Price Policies After *Leegin*

Defendants can defend any rule of reason case by rebutting the plaintiffs' proof of anticompetitive effects (such as those described above), but the Court in *Leegin* highlighted some particular procompetitive justifications applicable to minimum resale price policies.

The Court noted that minimum resale price agreements can prevent discounting retailers from free riding on the service provided by other retailers.[16] This holds particular interest for manufacturers like Leegin that seek to promote top quality service for their products. The Court also pointed to the possibility that minimum price agreements will facilitate "market entry for new firms and brands" and increase interbrand competition.[17] Likewise, they may "encourag[e] retailers to invest in tangible or intangible services or promotional efforts" and give consumers "more options" on the spectrum of price-service mix (even in the absence of free riding).[18] Finally, such agreements can encourage stocking of adequate inventories in the face of uncertain demand.[19]

State Laws in the Wake of *Leegin*

A less-appreciated but perhaps equally significant issue for every business engaged in, or relying on, distribution and retailing concerns the future treatment of minimum resale price agreements under state antitrust law. It remains unclear whether and to what extent the states will follow the Supreme Court's lead in *Leegin*. State antitrust laws often follow federal law, but some states have shown a willingness in the past to step out on their own in the face of Supreme Court precedent with which they disagree. The most striking recent example is provided by the more than twenty states that have "repealed" the Supreme Court's decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), on indirect purchaser standing, either through legislative action or judicial decision. This state trend revolutionized many aspects of private antitrust litigation, and to a large extent prevented *Illinois Brick* from achieving its intended purpose of denying indirect purchasers an opportunity to assert treble-damage claims.

And, indeed, in *Leegin*, thirty-seven states filed an amicus curiae brief urging the Court to uphold *Dr. Miles*. The issue of minimum resale price agreements is clearly on the radar screens of state Attorneys General, and some may call for their state legislatures and courts to retain the *per se* standard. It remains to be seen whether all states will follow *Leegin* or whether some will choose to retain (or re-establish) a *per se* rule under state law.

If any significant number of states in fact refuses to follow *Leegin*, the result may be a patchwork of laws on vertical resale price maintenance, which will have to be navigated carefully. Manufacturers who choose to establish minimum resale price policies in the wake of *Leegin* will have to keep a close eye on the state legislatures and courts. Conceivably, for national and global businesses, such a patchwork result could blunt or even eliminate the impact of *Leegin*, much as the state repealer statutes have done for businesses that otherwise sought to rely on *Illinois Brick*.

Take-Aways from *Leegin*

In light of the new legal landscape created by the Supreme Court's decision in *Leegin*, the following points should be noted:

- Manufacturers and other suppliers will have more flexibility to establish minimum resale price agreements with distributors.
- Businesses with minimum resale price policies should become much more aware of state laws governing this practice.
- Businesses should become much more attentive to potential procompetitive justifications for minimum resale price agreements, such as preventing free riding, encouraging new entry, motivating the provision of customer service at the retail level, and promoting interbrand competition in other ways.
- Resale price maintenance agreements may still be condemned under the rule of reason if they have anticompetitive effects. The Court in particular expressed concern that such agreements not be used to facilitate cartels, and warned that they could be abused by dominant retailers or manufacturers.

Endnotes

[1] No. 06-480, 551 U.S. __ (2007).

[2] 220 U.S. 373 (1911).

[3] 171 Fed. Appx. 464 (2006) (*per curiam*).

[4] *Leegin*, Slip Op. at 6.

[5] *Id.*, quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 US 36, 50 (1977) and *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 US 284, 289 (1985) (internal quotation marks omitted).

[6] *Leegin*, Slip Op. at 9.

[7] *Id.* at 10.

[8] *Id.* at 28.

[9] *Id.* at 13.

[10] *Id.* at 13.

[11] *Id.* at 14, 18.

[12] *Id.* at 14.

[13] *Id.*

[14] *Id.* at 18.

[15] *Id.* at 19.

[16] *Id.* at 10-11.

[17] *Id.* at 11.

[18] *Id.* at 10.

[19] *Id.* at 10-12.

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